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IN THE

Supreme Court of the United States

October Term, 1985

IRVING and CHARLOTTE RADOL, *et al.*,

Petitioners,

v.

W. BRUCE THOMAS, *et al.*,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

BRIEF FOR THE RESPONDENTS IN OPPOSITION

HALIBURTON FALES, 2d*
RICHARD J. HOLWELL
THOMAS McGANNEY
RICHARD W. REINTHALER
DWIGHT A. HEALY

WHITE & CASE
1155 Avenue of the Americas
New York, New York 10036
(212) 819-8200

JOHN W. BEATTY
DINSMORE & SHOHL
2100 Fountain Square Plaza
Cincinnati, Ohio 45202
(513) 621-6747

Attorneys for Respondents: United States Steel Corporation, et al.

ERWIN N. GRISWOLD
JOHN L. STRAUCH*
JOHN M. NEWMAN, JR.
ROBERT R. WELLER
JOHN W. EDWARDS II
JAMES R. JOHNSON

JONES, DAY, REAVIS & POGUE
1700 Huntington Building
Cleveland, Ohio 44115
(216) 348-3939

Attorneys for Respondents: Marathon Oil Company, et al.

* *Counsel of Record.*

Counterstatement of the Question Presented for Review

Does this Court's opinion in *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438 (1976), require a court of appeals to overturn a jury verdict that the nondisclosure during a tender offer of speculative, future-oriented, asset evaluations, which were prepared as optimistic selling tools, did not violate §§ 10(b) or 14(e) of the Securities Exchange Act of 1934?

Statement of the Parties To This Proceeding

Respondent Marathon Oil Company is now a wholly-owned subsidiary of Respondent United States Steel Corporation, and portions of its business are operated as separate, wholly-owned subsidiaries of United States Steel Corporation. In addition to its wholly-owned subsidiaries, Marathon Oil Company is affiliated with the following entities:

Arctic LNG Transportation Company
Badger Pipe Line Company
City Point Oil Terminal, Inc.
CLAM Petroleum Company
Cook Inlet Pipe Line Company
Deutsche Transalpine Olleitung GmbH
Explorer Pipeline Company
Gravcap, Inc.
Green Bay Terminal Corporation
Kenai LNG Corporation
LOCAP, Inc.
LOOP Inc.
Oasis Oil Company of Libya, Inc.
Oil Insurance Limited
Petroleum Terminals, Inc.
Pilot Oil Corporation
Platte Pipe Line Company
Polar LNG Shipping Corporation
Russell Stewart Oil Co.
Societa Italiana Per L'Oleodotto Transalpino, S.p.A.
Transalpine Finance Holdings S.A.
Transalpine Olleitung in Osterreich GmbH
West Shore Pipe Line Company
Wolverine Pipe Line Company

In addition to subsidiaries which are wholly-owned, including Marathon, Respondent United States Steel Corporation is affiliated with the following entities:

Athlone Prospecting & Development Corporation, Ltd.
First National Bank (Albion, Pa.)

Companhia Meridional de Mineracao
Brazaco-Mapri Industries Metalurgicas S.A.
ITW-Mapri (51% owned by Brazaco-Mapri)
Mecania Walsywa, Ltda.
Companhia Siderurgica Paulista "Cosipa"
Merinds Mineracao
Mineracao Buritirama Ltda.
Mineracao Carajas, Ltda.
Mineracao Maraba, Ltda.
Mineracao Xingu, Ltda.
Termerid Mineracao, SA
Torremco Soc. Min. E. Com. Ltda.
Deepsea Ventures, Inc.
Ocean Mining Associates
FHS Stahlverformung GmbH
FHS Automotive Parts Manufacturing Ltd.
Industria de Tubos y Perfiles, S.A. (Intuperas)
Minerales Ordaz C.A.
Les Entreprises du Lac Lucault Inc.
Sidbec-Normines, Inc.
U.S. Steel France
Zaerust Chrome Mines, Limited
Northern Tier Pipeline Co.
USS MaxTech Company, Inc.
USS MaxTech Company, Ltd.
USS Max Tex Company (Japan), Ltd.
USS Technology (Japan), Ltd.
ACE Holdings, Ltd.
Adela Investment Company, S.A.
Altos Hornos de Viscaya, S.A. (AHV)
Associated Ore & Metal Corporation, Ltd.
Avsteel SWA, Ltd.
Blue Grass Phosphate Company
Chrome Deposit Corp. (Court Holdings J.V.)
Jupiter Mining and Prospecting Co. (Pty.) Ltd.
Kappa Mining & Prospecting Co., Ltd.
La Pointe Iron Company
Navios Corporation

Navios Ship Management Services, Inc.
Oresteel Investments (Proprietary), Ltd.
P.T. Pacific Wikkel Indonesia
Sigma Mining & Prospecting Co. (Pty.) Ltd.
Societe Des Mines De Fer De Guinea Pour L'Exploitation Des Monts Nimba (Mifergui Nimba)
Tilden Iron Mining Company
West Union Canal Company, The
Bartow Chemical Products
Century III Associates
Fort Meade Chemical Products
Double Eagle Steel Coating Co.
Live Oak Uranium Operations
Rockland Joint Venture
RMI Company
Tenneco/USS Chemicals Joint Venture

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October Term, 1985

No. 85-1030

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Petitioners.

v.

W. BRUCE THOMAS, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

BRIEF FOR THE RESPONDENTS IN OPPOSITION

Opinions Below

The opinion of the Court of Appeals for the Sixth Circuit is reported at 772 F.2d 244. That court's decision in a companion case, *Starkman* v. *Marathon Oil Co.*, is reported at 772 F.2d 231. Both opinions, together with the district court's decision on summary judgment, reported at 556 F. Supp. 586, are attached to the petition.

Statutes and Regulations Involved

The following statutes and regulations are cited in this Brief and reproduced in the Appendix:

Securities Exchange Act of 1934:

§ 10(b), 15 U.S.C. § 78j(b) 1A
§ 14(e), 15 U.S.C. § 78n(e) 1A
§ 23(a)(1), 15 U.S.C. § 78w(a)(1) 2A

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SEC Reg. S-X, 17 C.F.R. § 210.4-10(k)(5)-(6) 18A

I.

Statement

A. Introduction

Petitioners would have this Court believe that the court of appeals below fashioned some broad policy statement regarding disclosure of asset valuations which is contrary to this Court's decision in *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438 (1976) ("*TSC*"), and the decision of the Third Circuit in *Flynn* v. *Bass Brothers Enterprises, Inc.*, 744 F.2d 978 (3d Cir. 1984) ("*Flynn*") (a case decided *after* trial below), and which is inimical to the best interests of shareholders generally. They invite this Court, rather than deciding this case on its facts, to articulate "[a] fair, coherent, and consistent standard . . . as to when [asset] valuations should be disclosed." (Pet. 6).

In truth, the court of appeals properly confined its decision to the case before it and found, in a manner

entirely consistent with *TSC* and *Flynn*, that petitioners' claim of securities fraud should not have been submitted to the jury in the first instance. That claim involved the nondisclosure, during a tender offer by United States Steel Corporation ("U.S. Steel") for 51% of the shares of Marathon Oil Company ("Marathon" or the "Company"), of two "selling documents" containing speculative evaluations of Marathon assets, which have become known as the First Boston Report and the Strong Report. The court of appeals rejected the claim under both *TSC* and the uniform body of case law which existed at the time and which held that speculative appraisals, forecasts, and projections are not "material facts" required to be disclosed to investors under the federal securities laws.

The *Flynn* case, decided in 1984, recognized the uniform rule and its application in prior decisions of the Third Circuit and elsewhere. It remains to be seen whether the test for disclosure of certain "soft" information announced in *Flynn* will prove to be any different in application from the prior articulations of the rule. Even if *Flynn* is subsequently viewed as adopting a different rule, it does not create a conflict with the Sixth Circuit's decision in this case. That is because the *Flynn* court announced that its rule was to be applied prospectively only. Nevertheless, even if the rule were applied to the Strong and First Boston Reports involved here, the result would be the same.

The petition focuses only on the portion of the jury charge entitled "Representations Concerning the Future." While this charge was manifestly correct, petitioners' isolation of one portion of the charge distorts the whole of the charge on materiality and on petitioners' nondisclosure claim generally. See Appendix for the entirety of the district court's charge on materiality. The district court began its instructions by quoting the pertinent portions of the governing statutes and rules (including those portions making it unlawful to "omit to state a material fact necessary in order to make the statements

made in the light of the circumstances under which they were made not misleading"), and by stating that the purpose of Congress in enacting these provisions was "to require a policy of full disclosure." (Tr. 2645). The court then set forth the elements of a claim under these provisions. In its discussion of these elements, the court instructed the jury that they must "determine whether the omission of the Strong or First Boston Reports constituted a failure to disclose a material fact" and that "an omitted fact is material if there is a substantial likelihood that a reasonable person would consider it important in deciding whether to tender his stock." (Tr. 2648). In addition, the court instructed on the law applicable to projections and forecasts. (Tr. 2647-48). The language of the court's instructions closely tracks this Court's decision in *TSC* and the clear weight of authority from other courts.

Applying this charge to the evidence at trial, the jury's verdict is hardly surprising. Rather than the objective, expert appraisals painted by petitioners, the jury was presented with evidence demonstrating that the Strong and First Boston Reports are paradigms of the type of speculative, future-oriented information which is "of dubious significance that insistence on its disclosure may accomplish more harm than good." *TSC*, *supra*, 426 U.S. at 448.

In sum, there is here neither a departure from the rule embodied in the decisions of this Court nor a clear and existing conflict among the circuits. This is not, therefore, an appropriate case in which to reconsider the disclosure requirements of the federal securities laws or to promulgate general rules concerning the materiality of theoretical asset valuations. Supreme Court Rule 17.

B. The Origins of the First Boston and Strong Reports

In mid-July 1981 Marathon[1] asked its financial advisor, The First Boston Corporation ("First Boston"), to prepare a review of the Company's assets, using publicly available information, to be used in the event of an inadequate tender offer for the Company. First Boston presented its results orally to the Marathon Board on October 31, 1981, the day after Mobil Corporation ("Mobil") had announced a hostile tender offer to purchase 68% of Marathon's shares at a price of $85 per share. A written draft of the review was presented to the Board on November 5, 1981. First Boston cautioned the Board that the projections in its Report, which contained per share figures of $188 and $226, should not be confused with the price which could actually be obtained for Marathon as a going concern or in liquidation. (*E.g.*, Tr. 833-34, 865-66, 890-91, 1921-22). That caution sprang from the reality of the marketplace: market analysts had published numerous, theoretical asset valuations of petroleum companies, including Marathon, in the same range as the First Boston and Strong Reports, but Marathon's stock had closed at $63.75 per share the day before the Mobil offer and had never traded anywhere near the range of those theoretical valuations. (DX 858; Tr. 244-49, 1401-02).

The jury also learned that the Strong Report had been initiated in the summer of 1981, when Marathon's President, Mr. Hoopman, asked each operating division to compile a catalogue of its assets with optimistic projections of value to use to attract alternate bids in the event of an inadequate tender offer. As the court of appeals noted,[2] the Strong Report, like the First Boston Report, was not prepared in the ordinary course of business but

1. Marathon was a publicly-owned Ohio corporation engaged in all phases of the petroleum industry and had over 58,600,000 shares of common stock outstanding, held by over 35,000 shareholders. Marathon ranked 38th on the then-current *Fortune* 500 list.

2. The Strong and First Boston Reports are discussed extensively in the companion case to this one, *Starkman* v. *Marathon Oil Co.*, 772 F.2d 231, 233-35 (6th Cir. 1985), *pet. for cert. filed*, No. 85-1029 (Dec. 13, 1985). Petitioner in that case does not seek review of that portion of that decision.

was instead a "selling document." In that vein, Mr. Hoopman told his people to "take off your engineers' hats and put on your sales hats" and to look at the assets through "rose-colored glasses" when assigning values.[3] (Tr. 675, 885, 1626-28, 1631-33, 2109, 2143). Consistent with Mr. Hoopman's mandate, the Strong Report arrived at per share figures of $276 and $323 for Marathon's assets.

C. The Contents of the Reports

In light of the market price of Marathon shares before the Mobil offer, compared to publicly-available theoretical asset values in the same range as the Reports, it is hardly surprising that petitioners made no effort at trial to demonstrate that anyone believed that shareholders could hope to realize any price in that range for their shares. Indeed, petitioners' own expert testified that an asset evaluation does not reflect the fair market value of a company's stock and that there is not even any clear relation between the two. (Tr. 1031-32).

Moreover, the evidence showed that the asset values themselves were highly speculative and inaccurate. Oil and gas reserves were assigned values in the Reports based on discounted cash flows ("DCF").[4] At the beginning of

3. Petitioners quote an excerpt from a letter of Marathon's general counsel, Mr. Hampton (Pet. 10), to convince this Court that the Strong Report was intended to be an estimate of present market value. The jury plainly rejected that contention after hearing all the evidence, particularly that which showed that Mr. Hampton's letters were intended to bring proprietary information within the attorney-client privilege and not to countermand Mr. Hoopman's prior instructions to use "rose-colored glasses."

4. Petitioners make the statement that "the uncontradicted evidence was that investment analysts and others routinely consider valuations like those involved here to be important in making business decisions . . . ." (Pet. 6). That statement is both inaccurate and irrelevant. At best, the record below would support a claim that persons in the oil and gas business, who appreciate the limitations of such analyses, frequently use a DCF analysis, together with other information, when evaluating oil and gas properties. There was no showing, nor could there be, that anyone would employ the same highly optimistic assumptions and predictions which went into the DCF sections of the Reports in making unspecified "business decisions."

a DCF, an estimate is made of the oil and gas reserves in each of the Company's fields. The useful life of the field is then estimated, and a forecast is prepared of how much oil may be extracted from that field in each year of its useful life.[5]

To forecast future gross revenues to be received from the oil or gas which it is estimated will be extracted from a particular field in each year of the field's useful life, a projection must be made of the price to be received for each product in each year of the useful life of a field (which can be 50 years or more). Price projections of equally qualified economists differ widely for any year, and such differences have an enormous impact on succeeding stages of a DCF.

After calculation of projected annual gross revenues by multiplying the predicted price by the estimated number of barrels of oil to be produced in that year, net revenues in any year are calculated by subtracting estimates of the capital and expenses involved in the extraction of that oil.[6] After net reserves are estimated, the DCF methodology requires the selection of a discount rate to reduce estimated future net revenues to a present value. The choice of a rate is highly subjective, and analysts differ on appropriate rates and the factors used to select the rate. The rate has a very significant impact on the resulting present value.[7]

5. As the jury heard, how much oil will be produced in a year from a particular field depends not only on geologic estimates but on a forecast of market demand in that year, whether the owner will have the funds needed to extract the oil in that year, and whether the price for oil justifies the production costs. For those states which regulate extraction rates, the rate which will be permitted in that year must be predicted.

6. Those estimates, in turn, depend on estimates of the cost of money, the availability and price for steel, labor and energy and on forecasts of future government taxation policies.

7. For example, a difference of 3 percentage points in the alternate discount rates presented in the Strong Report resulted in a difference of $2 billion.

As the evidence established, DCF methodology is highly speculative and its results are susceptible to manipulation in the choices of the many estimates and outright guesses necessarily incorporated in it. The jury heard much evidence that the estimates chosen were consistent with the selling document purpose of the Reports. For example, the Strong Report assumed that the State of Texas would permit Marathon to increase its extraction of oil from its most important domestic reserve, the Yates Field, by 25,000 bbls./day. In fact, Marathon never received that permission, and the Report's projection of gross production from Yates was overstated by 9,000,000 bbls./year as a result of that single optimistic but erroneous prediction.[8]

By definition, the existence of, and ability to extract, probable reserves is even more uncertain than proven reserves. Yet no risk factors were applied to the present values assigned to probable reserves in the Strong Report; they were treated precisely the same as proven reserves. While geologic risk factors were used in the DCF evaluation of potential reserves, a host of other uncertainties was not factored into the values assigned those prospects in the Strong Report. Many of the potential reserve projects were jointly owned by Marathon and other oil companies, whose approval for exploration, though necessary, had, in many cases, not yet been sought. Contrary to normal budget practices, the Report assumed unlimited funds to conduct exploration and development programs simultaneously on all predicted schedules.

While the jury heard evidence of many other optimistic and even unrealistic assumptions,[9] one further example regarding domestic oil and gas properties should suffice.

8. Similarly, the First Boston Report contained an erroneous assumption that the Yates Field contained 150,000,000 bbls. of recoverable oil that had not been publicly reported. After delivery of the First Boston Report, it was discovered that Marathon had already publicly reported those reserves and, thus, that the Report had erroneously "double-counted" them.

9. The First Boston Report used crude oil price projections which by the fall of 1981 were already known to be too high.

Values were assigned to estimated reserves for prospects where Marathon had not yet acquired any drilling rights. Simply stated, the Report listed as assets of Marathon, and ascribed values thereto, potential reserves which, if they existed at all, Marathon did not even own but only hoped it could acquire in the future.

Much the same optimism was shown regarding Marathon's international oil and gas reserves. Petitioners' expert conceded that "all foreign oil and gas assets were overstated." (Tr. 1295-96). No attempt was made in the Strong Report to distinguish the different political risks attendant to hypothetical future revenue streams from countries with vastly different political and economic regimes. For example, no distinction was made between projected future revenues from Marathon's estimated reserves in the United Kingdom and those from its unsaleable estimated reserves in Col. Qaddafi's Libya, which were valued at approximately $1 billion.

The per share values in the Reports also rested on valuations of other assets not prepared using a DCF analysis. Refineries were valued at the undepreciated cost of replacing them in their existing configurations, notwithstanding that their market values were significantly less. Similarly, values assigned to Marathon's pipelines and ships, mainly replacement values, were known to be unrealizable in a sale and were conceded by one of petitioners' experts to be "overstated" and not a reflection of fair market value. (Tr. 1295). In addition, whole pipeline systems owned or partially owned by Marathon and its interests in certain marketing and foreign affiliates were erroneously double-counted. The balance sheet adjustment portion of the Strong Report failed to set off hundreds of millions of dollars of liabilities, and the DCF evaluations, themselves, failed to net out almost $500 million in pre-tax annual overhead and interest expenses.

It is also important to note that neither Report contained any significant factual information not already in the public domain. The First Boston Report was ad-

mittedly derived from publicly available information. That Report added only First Boston's DCF projections, which were of a kind any analyst could have made, and many did make, on the basis of the same public information. In view of the wealth of information disclosed in Marathon's Annual Reports, the same can be said about the Strong Report. There was no evidence that the Strong Report revealed some important asset of Marathon which had never been publicly disclosed. There were no secret oil discoveries revealed for the first time in the Report.

The complaint, in footnote 12 of the petition, that "the Sixth Circuit nowhere explained why defendants were not obligated to disclose the asset valuations at least to the extent of Marathon's *proven* reserves," rings somewhat hollow in view of the estimates of Marathon's proved reserves, with values assigned in accordance with requirements of the Securities and Exchange Commission ("SEC"), which appeared in Marathon's Annual Reports.[10]

D. Use of the Reports

Both the First Boston and Strong Reports were discussed with the Marathon Board at its October 31, 1981 meeting to consider the Mobil tender offer. First Boston advised the Board that Marathon could not expect to receive a price which resembled the theoretical asset values and that such values would not be important or helpful in obtaining a higher bid. The Marathon employees who discussed the Strong Report told the Board it was a selling tool and made clear that its projections were not intended to, and did not, represent the price that could be realized in a sale of Marathon as a going concern or in liquidation.

10. Marathon's public reports contained hypothetical values for its assets prepared in accordance with SEC requirements which were very different from the assumptions employed in the Strong Report. For example, in its Annual Reports, Marathon presented a DCF analysis of proved reserves which complied with the SEC requirement that the price of oil be held constant at its existing level. The DCF in the Strong Report assumed that oil prices would constantly increase for up to 20 years in the future, reaching in excess of $200/bbl.

The jury learned that, despite their resolve to oppose Mobil's tender offer on all legitimate fronts, the Marathon respondents did not, in that effort, disclose the speculative values contained in the Reports to the shareholders for fear of misleading them. Petitioners' own expert recognized that "selling documents" are frequently prepared by companies facing tender offers and should not be disclosed publicly. (Tr. 1290-97).

In an effort to develop a better alternative to Mobil's bid, Marathon attempted to use the Reports to interest potential bidders, but the jury learned that the recipients of the Reports dismissed them as mere sales tools and that, of the comparatively few bids advanced, none was based on the values contained in the Reports.

For its part, U.S. Steel placed no reliance on either Report. While Mr. Corry of U.S. Steel reviewed briefly the Executive Summary of the Strong Report, he dismissed it as a "trumped-up piece of junk," and it played no role in his evaluation of Marathon or the formulation and approval of the U.S. Steel proposal by management and the Board of Directors. (Tr. 313-14, 389). What U.S. Steel did find useful were Marathon's 5-year earnings projections, which it subsequently disclosed to shareholders in its offering materials.

The agreement between Marathon and U.S. Steel announced on November 19, 1981 provided that U.S. Steel would make a tender offer for 51% of Marathon's outstanding shares at $125 per share. Thereafter, the shareholders would be asked to approve a merger, in which each remaining share would be exchanged for a $100 principal amount, 12 year, 12½%, guaranteed Note.[11] Because the Reports

11. The Notes are publicly-traded. Their market price fluctuates in a generally inverse relationship to prevailing interest rates. At the time the agreement between Marathon and U.S. Steel was announced, their estimated trading price was $86. At the time of the merger, they were trading at $76. But, on May 6, 1983, just prior to trial, they were trading at $103⅞.

The price received by Marathon shareholders after they had accepted U.S. Steel's offer represented a 76.7% premium over the

(footnote continued on next page)

were potentially misleading selling documents which had not been relied upon by either Marathon or U.S. Steel, neither Report was disclosed in the tender offer materials.

After the tender offer was completed, a Proxy Statement was sent to Marathon's shareholders in connection with the proposed merger of Marathon into U.S. Steel. The merger was technically a "going private" transaction subject to SEC Rule 13e-3, 17 C.F.R. § 240.13e-3, which required disclosure of, *inter alia*, "outside appraisals," regardless of their materiality. Because the First Boston Report arguably fell within that provision of Rule 13e-3, it was disclosed in the Proxy Statement, and, under those circumstances, the Strong Report was also disclosed, with appropriate disclaimers as to reliability.

Contrary to petitioners' theory, after disclosure of the Reports, U.S. Steel's stock fell both absolutely and in relation to the market. (Tr. 1409-10, 1416-30; DX 884-90).

E. Treatment of the Reports in the Courts Below

To summarize the evidence heard by the jury in the district court, there was:

- clear and undisputed evidence of the uncertain and unrealistic methodologies employed in the Strong and First Boston Reports to project asset values;
- clear and undisputed evidence of optimistic and unapparent assumptions, shortcomings, contraindications, and outright errors which underlay the application of those methodologies in this instance;

1981 average trading price of Marathon stock and was higher than the premium paid in 73.5% of the contested tender offers and 95% of the uncontested tender offers between 1979 and March 10, 1982. It was the highest premium paid in any acquisition of an oil company during the period, including the DuPont acquisition of Conoco. Petitioners state that this case "arises out of the extinction of the rights of thousands of class members . . . ." (Pet. 3). In fact, the shareholders of Marathon overwhelmingly and voluntarily decided to sell their shares for the price offered by U.S. Steel. As one of the petitioners was himself advised by his counsel of record in this case: "It is a great deal. Take it." (Tr. 1981).

- admission by petitioners' expert that the asset values contained in the Reports were not values that could be realized in a sale of Marathon's assets and did not reflect the fair market value of Marathon stock (Tr. 1027, 1031-32);
- an admission by petitioners' expert that the values assigned to Marathon's oil and gas reserves were derived by a process which was not "certain or substantially certain" (*id.*);
- an admission by petitioners' expert that the values assigned to Marathon's downstream assets (refineries, pipelines, etc.) and the international oil and gas reserve portion of its upstream assets were overstated (Tr. 1295-96); and
- undisputed evidence that the values assigned to Marathon's proved domestic oil and gas reserves in the Reports were prepared in a manner inconsistent with SEC requirements, but that estimates of the quantity and value of those reserves prepared in accordance with SEC requirements had been provided to shareholders in Marathon's Annual Reports.

As discussed above, the trial court gave comprehensive instructions to the jury, including those on the issue of "materiality," which were taken directly from this Court's opinion in *TSC*, *supra*, 426 U.S. at 449.[12]

The court of appeals approved the jury instruction but noted that the district court, in its earlier refusal to grant summary judgment on the nondisclosure claim, had

12. The district court went on to instruct on the law applicable to projections and forecasts as noted on page 17 of the petition. Petitioners fail to note, however, that the court permitted petitioners to argue to the jury the meaning of the legal standard on projections contained in his charges. Petitioners took that opportunity to argue that neither Report was a prediction regarding future events and that the "substantial certainty" requirement was satisfied here by a claimed showing that the projections were prepared in good faith by qualified persons using accepted methodologies. (Tr. 2471-72, 2630-32).

employed a standard which was expressly rejected by this Court in *TSC* and that, if the proper *TSC* standard had been employed, the issue of materiality should not have gone to the jury. (772 F.2d at 252-53). The court noted that the duty to disclose "soft" information based on predictions regarding future economic and corporate events arises only if the predictions are "substantially certain to hold." (*Id.* at 253). It went on to find that "in any event . . . there was no duty to disclose the asset appraisals at issue here." (*Id.*).

II.

Summary of Argument

The decision below does not conflict with this Court's test for materiality. The Sixth Circuit held that speculative projections of the future and estimates of value based thereon need not be disclosed, unless such projections are "substantially certain to hold." Whether the Sixth Circuit's decision is viewed as a further refinement of the general materiality standard of *TSC* when speculative information is involved or a preliminary analysis of whether there is a "fact" to which the *TSC* test for materiality is to be applied, it is entirely consistent with numerous decisions before and after *TSC*, which have uniformly concluded that disclosure of the type of speculative information involved in this case is not required.

No genuine conflict between the decision below and the Third Circuit's decision in *Flynn* is presented in this case. The "test" for disclosure of soft information announced in *Flynn* in 1984 was expressly made prospective and would not be applied to the 1981 events in this case, even in the Third Circuit. The *Flynn* test has yet to be applied in any subsequent case and may turn out to be no different in application from the decision below. Even if the *Flynn* test were applied at face value to the facts of this case, the same result would be reached.

The Sixth Circuit properly understood and interpreted the applicable regulations and policies of the SEC. Under the regulations in effect at the time of U.S. Steel's tender offer, disclosure of the Strong and First Boston Reports was prohibited.

III.

Reasons For Denying The Writ[13]

A. There Is No Conflict Between the Court of Appeals' Decision and This Court's Opinion in *TSC*.

Petitioners erroneously contend that the courts below applied a standard of materiality in conflict with this Court's decision in *TSC*. The district court charged the jury in language taken directly from *TSC*, and the court of appeals expressly acknowledged the language employed by the district court from *TSC* as the correct general test for materiality. 772 F.2d at 253.

Thus, petitioners' putative conflict between *TSC* and the Sixth Circuit's decision is elusive, to say the least. It appears, however, that their argument reduces to a syllogistic claim that persons investing in oil and gas reserves routinely use appraisals, employing a DCF analysis which is inherently speculative; the First Boston and Strong

13. Respondent First Boston was Marathon's financial advisor, and respondent Goldman Sachs was U.S. Steel's financial advisor. They were joined as defendants below but dismissed prior to trial upon stipulation of petitioners. In that stipulation, petitioners reserved the right to continue this action against First Boston and Goldman Sachs only as to those claims dismissed by the district court's Order of February 1, 1983 granting partial summary judgment. Although petitioners do not seek review in this Court of any of the claims dismissed in that Order, petitioners have named First Boston and Goldman Sachs as respondents herein. Respondents have been authorized to state that First Boston and Goldman Sachs join in the arguments presented herein, by their respective counsel, Ronald S. Rolfe, Esq., Cravath, Swaine & Moore, One Chase Manhattan Plaza, New York, N.Y. 10005, (212) 422-3000 and Melvyn L. Cantor, Esq., Simpson Thacher & Bartlett, One Battery Plaza, New York, N.Y. 10005, (212) 483 9000.

Reports are such appraisals; therefore, the Reports would be material to an investor deciding to tender his shares. (Pet. 21-23). The argument is wrong in fact, logic and law.

First, as summarized previously, the Reports were not straightforward asset appraisals prepared in the ordinary course of business. There was no evidence that anyone would use selling documents filled with the optimistic assumptions and predictions in the Reports when making a decision to invest in oil and gas properties. Certainly, none of the companies provided with copies of the Reports, including U.S. Steel, considered them important—had they given them any credence, one would have expected a bidding war of historic proportions to have ensued.

Second, even if the Reports were the type painted by petitioners, it does not follow that they would be material to investors deciding whether to tender their shares.[14] The evidence which the jury heard was that the market routinely ignored the many published, speculative asset appraisals in determining the fair market value of the stock of oil and gas companies. Materiality is not simply a free-floating concept but must be determined in a particular context.[15]

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14. Indeed, it is petitioners who seek to alter the materiality standard set forth in *TSC* by arguing, in effect, that no matter how speculative or unreliable a forward-looking appraisal or estimate might be, it should be considered material as long as it might serve some business purpose in some context, no matter how unrelated. This notion is contrary to *TSC*'s focus on reasonable investors and is refuted by the cases interpreting *TSC*. *E.g., James* v. *Gerber Products Co.*, 587 F.2d 324, 327 (6th Cir. 1978); *Vaughn* v. *Teledyne, Inc.*, 628 F.2d 1214, 1221 (9th Cir. 1980); *see Rochez Bros., Inc.* v. *Rhoades*, 353 F. Supp. 795, 802 (W.D. Pa. 1973), *vacated and remanded on other grounds*, 491 F.2d 402 (3d Cir. 1974); *Fisher* v. *Plessey Co.*, 559 F. Supp. 442 (S.D.N.Y. 1983).

15. *See South Coast Services Corp.* v. *Santa Ana Valley Irrigation Co.*, 669 F.2d 1265, 1272 n.4 (9th Cir. 1982) ("[T]he determination as to whether the estimates were based on sufficiently objective and reasonably certain data as to allow disclosure does not turn . . . on the other uses to which the estimates were put."); *Flynn, supra*, 744 F.2d at 989 (even reliance by the seller on speculative

(footnote continued on next page)

Third, the court of appeals dealt with a question which was not addressed by this Court in *TSC*. The undisclosed information in *TSC* was not speculative, future-oriented information, but facts involving stock holdings and stock purchases which had already occurred. (426 U.S. at 442-43). This Court's emphasis in *TSC* upon "the omitted *fact* [which] would have assumed actual significance in the deliberations of the reasonable shareholder," 426 U.S. at 449, provides a test of materiality *after* it has first been determined that the nondisclosed information is a fact. The "substantial certainty" instruction, upheld by the court of appeals, guided the jury in determining whether there was any "fact" to be disclosed, material or immaterial. It is entirely consistent with *TSC* for the court of appeals to have concluded that "soft" information must be tested against the general materiality standard only if the predictions underlying that information are "substantially certain to hold." 772 F.2d at 252-53.[16]

Regardless of whether the court of appeals' decision is viewed as a further refinement of the general materiality standard of *TSC* when speculative information is involved

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appraisals would not require disclosure to investors as material facts); *Seaboard World Airlines, Inc.* v. *Tiger International, Inc.*, 600 F.2d 355, 361-62 (2d Cir. 1979) (where stock is freely and actively traded, market price, not theoretical asset value, is the only proper basis for determining the value of a business).

16. Thus, it is wrong for petitioners to state, in their attempt to manufacture a conflict with *Flynn*, *supra*, that the court of appeals decision "means that [asset] valuations need never be disclosed." (Pet. 4). The court of appeals specifically noted that "a tender offer target must disclose projections and asset appraisals . . . only if the predictions underlying the appraisal or projection are substantially certain to hold. An example is when predictions in fact state a fixed plan of corporate activity." *Starkman* v. *Marathon Oil Co.*, *supra*, 772 F.2d at 241. It is this latter type of activity which was at issue in *SEC* v. *MacDonald*, 699 F.2d 47 (1st Cir. 1983), quoted extensively by petitioners. *MacDonald*, unlike the instant case, involved insider trading where the option of refraining from trading was readily available to the possessor of the undisclosed soft information. Moreover, the *MacDonald* court noted that "at the time of the stock purchases the lease was close enough to a sure thing as hardly to be considered a contingency at all." *Id.* at 50.

or a preliminary analysis of whether there is a "fact" to be further analyzed under the *TSC* materiality standard, it is correct and consistent with other reported decisions since *TSC* which have dealt with the same question in the same manner.[17]

17. *E.g., Bicchele* v. *Cedar Point, Inc.*, 747 F.2d 209, 216 (6th Cir. 1984) (no liability for failure to disclose "selling document" based on speculative future projections or asset valuations); *Vaughn* v. *Teledyne, Inc.*, 628 F.2d 1214 (9th Cir. 1980) (speculative asset valuations need not be disclosed); *Rodman* v. *Grant Foundation*, 608 F.2d 64 (2d Cir. 1979) ("Full factual disclosure need not be embellished with speculative financial predictions."); *James* v. *Gerber Prod. Co.*, 587 F.2d 324, 327 (6th Cir. 1978) (after an extensive discussion of *TSC*, holding: "[F]uture sales, projections, forecasts and the like, only rise to the level of materiality when they can be calculated with substantial certainty."); *Caspary* v. *Louisiana Land & Exploration Co.*, 579 F. Supp. 1105 (S.D.N.Y. 1983), *aff'd*, 725 F.2d 189 (2d Cir. 1984) (petroleum company not required to release projections of oil exploration or recovery rates); *Dower* v. *Mosser Indus., Inc.*, 488 F. Supp. 1328 (E.D. Pa. 1980), *aff'd*, 648 F.2d 183 (3d Cir. 1981) ("Neither the courts nor the SEC have ever required disclosure of such future-oriented information."); *Bradshaw* v. *Jenkins*, [1983-84 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,719 (W.D. Wash. 1984) (no duty to disclose estimated value of energy loan portfolio); *Lewis* v. *Oppenheimer & Co.*, 481 F. Supp. 1199, 1208 (S.D.N.Y. 1979) ("Financial forecasts or speculations are not required by any statute, case, S.E.C. rule or regulation.").

The decision below is likewise consistent with numerous prior decisions from the Sixth Circuit and elsewhere holding that speculative projections of the future and valuations based thereon need not be disclosed. *See, e.g., Arber* v. *Essex Wire Corp.*, 490 F.2d 414, 421 (6th Cir.), *cert. denied*, 419 U.S. 830 (1974) ("[T]he law mandates disclosure only of existing material facts. It does not require an insider to volunteer any economic forecast."); *Marsh* v. *Armada Corp.*, 533 F.2d 978, 987 (6th Cir. 1976), *cert. denied*, 430 U.S. 954 (1977); *Kohn* v. *American Metal Climax, Inc.*, 458 F.2d 255, 265 (3d Cir.), *cert. denied*, 409 U.S. 874 (1972); *Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F.2d 1281, 1291-44 (2d Cir. 1973); *Sunray DX Oil Co.* v. *Helmerich & Payne, Inc.*, 398 F.2d 447 (10th Cir. 1968) (disclosure of probable petroleum reserves not required); *Del Noce* v. *Delyar Corp.*, [1976-77 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,670 (S.D.N.Y. 1976) (merger proxy not required to disclose estimated value of oil reserves or quantity of probable reserves); *Denison Mines Ltd.* v. *Fiberboard Corp.*, 388 F. Supp. 812, 819-21 (D. Del. 1974); *In re Brown Co. Securities Litigation*, 355 F. Supp. 574, 583-84 (S.D.N.Y. 1973).

In more basic terms, this Court should decline petitioners' invitation to establish a standard of materiality which would require the disclosure as a material fact of speculative values founded in significant part on projections of oil prices up to 50 years in the future and hypothetical revenue streams from unexplored acreage which has not yet been leased.

B. No Genuine Conflict Between the Third and Sixth Circuits Is Presented By This Case.

1. *The Prospective Test In* Flynn *Would Not Be Applied To Events Which Occurred Some Three Years Before It Was Promulgated.*

Petitioners strain to create a conflict between the decision of the Sixth Circuit below and the Third Circuit's decision in *Flynn*, but no such conflict is presented by this case. Although *Flynn* announced a multi-faceted "test" for whether "soft" information should be disclosed, which petitioners contend differs from the test applied by the Sixth Circuit below[18] (as well as by all other courts which have previously adjudicated the issue), the *Flynn* test, announced in 1984, was expressly made *prospective* in its application by the Third Circuit. Thus, even if this case were adjudicated in the Third Circuit, it would be decided under the principles of law applied by the courts below to the 1981 events underlying this case, rather than under the test subsequently announced in *Flynn*. The law in the Third Circuit was no different from that in the Sixth Cir-

18. The Sixth Circuit distinguished its decision from *Flynn* as follows (*Starkman* v. *Marathon Oil Co.*, *supra*, 772 F.2d at 241-42):

> "By its very nature, however, this sort of judicial cost-benefit analysis [in *Flynn*] is uncertain and unpredictable, and it moreover neglects the role of the market in providing shareholders with information regarding the target's value through competing tender offers. Our approach, which focuses on the certainty of the data underlying the appraisal or projection, ensures that the target company's shareholders will receive essentially factual information. . . ."

cuit at that time. *See Dower v. Mosser Industries, Inc., supra*, 488 F. Supp. 1328; *Kohn v. American Metal Climax, Inc., supra*, 458 F.2d 255.

In *Flynn*, the Third Circuit recognized the consistent reluctance of the courts to impose "potentially huge liability for nondisclosure, even if desirable as a matter of public policy," because, at the time of the alleged violation, the defendant's conduct was in accord with governing law.[19] Thus, while not foreclosing altogether the possibility that its newly-formulated rule might be applied in "other cases based on actions occurring before the date of this opinion" (744 F.2d at 988 n. 19), the panel in *Flynn* "set forth the law for disclosure of soft information as it is to be applied from this date on" and refused to apply its new test to the facts before it, which had occurred in 1976. (744 F.2d at 988). The same result would necessarily follow in this case. When the events at issue in this case occurred in 1981, the SEC and the courts were consistent in holding that "soft" information need not be disclosed. Even if *Flynn* were different from that standard, it was not decided until three years after the operative events of this case, and it would be singularly unfair to subject respondents to potential liability for conforming to what was then, and still is, the governing law but failing to anticipate the subsequent announcement by another court of a prospective, potential change in the law.

2. *The* Flynn *Test Has Not Yet Been Applied To A Real Case.*

Despite the adoption of a modified test for disclosure in *Flynn*, that test has yet to be "fleshed out" by application in decided cases. In the only cases which have cited *Flynn*, the courts have not yet applied its modified

19. *Flynn, supra*, 744 F.2d at 986, *citing South Coast Services Corp. v. Santa Ana Valley Irrigation Co.*, 669 F.2d 1265, 1271-72 (9th Cir. 1982); *Panter v. Marshall Field & Co.*, 646 F.2d 271, 292-93 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981); *Kohn v. American Metal Climax Co., supra*, 458 F.2d at 265.

test for disclosure of "soft" information.[20] Thus, precisely how the *Flynn* test will be applied in actual cases (assuming that the panel's decision remains the law in the Third Circuit) remains to be seen. Until further development of *Flynn*, it is premature to state unequivocally that it is in conflict with the rule of law applied by the Sixth Circuit below.

When and if the *Flynn* test is applied to actual cases, its multi-factor approach (discussed *infra*) may well turn out to be merely one approach to determining which information is "substantially certain" enough to constitute a "fact" subject to disclosure. In other words, actual application of the *Flynn* test may well obviate any potential conflict between the decision below and *Flynn*.

The likelihood that conflict will be obviated by future decisions is prefigured in *Flynn* itself. The Third Circuit concluded that, even under the demonstrative application of its "new" test to the appraisals before it, the trial court had properly directed a verdict for defendants, because plaintiffs had failed to show that the information was "sufficiently reliable to be material." *Flynn*, *supra* at 290. In *Starkman*, the Sixth Circuit left open the possibility that disclosure could be required where the predictions are "substantially certain to hold." (772 F.2d at 241-42). Thus, any real difference between the opinion below and *Flynn* may turn out to be illusory.

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20. *Lockspeiser* v. *Western Maryland Co.*, 768 F.2d 558, 561 (4th Cir. 1985) (noting the *Flynn* decision in holding that nondisclosure of amounts of coal and timber reserves, as opposed to valuations thereof, presented a triable issue of fact); *Nutis* v. *Penn Merchandising Corp.*, 610 F. Supp. 1573, 1579 (E.D. Pa. 1985) (citing *Flynn* without reference to its test for soft information); *Hecco Ventures* v. *Avalon Energy Corp.*, 606 F. Supp. 512, 520 (S.D.N.Y. 1985) (noting *Flynn*, but holding, with respect to a liquidation analysis, that "this is not a case in which such speculative disclosure should be required . . .").

3. *Even If* Flynn *Were Applied In This Case, The Strong and First Boston Reports Would Not Have To Be Disclosed.*

Regardless of whether a genuine conflict between the Third and Sixth Circuits' tests for disclosure of speculative information might be presented in future cases, no such conflict is presented in this case. Taking the elements of the *Flynn* test at face value, it is clear as a matter of law that, even if *Flynn* were applied to this case, the Strong and First Boston Reports would not have been required to be disclosed in response to the U.S. Steel tender offer.[21] The factors listed in *Flynn* (744 F.2d at 988), together with a summary of the relevant evidence in this case, are:

1. "*[T]he facts upon which the information is based*" —The facts underlying the Strong and First Boston Reports were publicly reported, with the exception of the estimates of the quantity of probable and possible petroleum reserves, which could not be disclosed under applicable SEC regulations.[22] Those few underlying facts were then translated into estimated "values" by the application of optimistic future projections and assumptions. Neither the projections nor the estimated "values" which resulted were even remotely factual in nature. (Tr. 717, 729, 1493-94, 1654, 1932-33, 2111-14).

2. *[T]he qualifications of those who prepared or compiled it*"—The Strong and First Boston Reports were prepared by employees of Marathon and First Boston, respectively. While those persons had expertise in petroleum

21. As discussed *infra*, disclosure of those Reports was not required and was indeed forbidden by the regulations of the SEC in effect at the time. Thus, respondents could not have been liable for nondisclosure in reliance upon those regulations. § 23(a)(1) of the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. § 78w(a)(1).

22. The quantity and hypothetical value of Marathon's proved reserves were disclosed publicly in accordance with SEC-mandated methodology. Permissible descriptions of exploratory acreage and drilling activity in pursuit of probable and possible reserves were also disclosed in Marathon's Annual Reports.

and finance, their qualifications to predict events up to 50 years in the future were not significantly different from those of any other mortal. *See Tanzer Economic Associates* v. *Haynie*, 388 F. Supp. 365, 368 (S.D.N.Y. 1974) ("Courts know what housewives and economists know—that nobody knows how to forecast safely in the current state of the economy.").

3. "*[T]he purpose for which the information was originally intended*"—Both Reports were prepared to be used as "selling documents," in an effort to obtain a higher bid if Marathon were the target of a tender offer at an inadequate price and were quickly perceived as such by potential bidders. (Tr. 676, 750-52, 885, 1626-28, 1631-33, 2109, 2143).

4. "*[I]ts relevance to the stockholders' impending decision*"—The evidence was clear that neither Report had any relevance to a shareholder's decision on whether to tender to U.S. Steel. First Boston cautioned Marathon's Board that speculative asset valuations should not be confused with the price which could actually be obtained for Marathon as a going concern or in liquidation. (Tr. 833-37, 856-66, 890-91, 1710, 1830, 1921-22, 1925). Marathon did not disclose the Reports in its efforts to defeat Mobil's tender offer. U.S. Steel gave no credence to the Reports, and they were not presented to its Board. Plaintiffs' own experts conceded that a DCF valuation of assets does not reflect the fair market value of a company's stock and that there is no clear relationship between the two. (Tr. 1031-32, 1034, 1406).

5. "*[T]he degree of subjectivity or bias reflected in its preparation*"—The Reports were prepared for use as "selling documents," and both reflect a resulting bias. As discussed above, both Reports utilized methodologies which are inherently subjective and uncertain, as evidenced by the fact that, even though they purport to measure the same company, the Reports differ by some $5 billion. (PX 102; DX 228).

6. "*[T]he degree to which the information is unique; and the availability to the investor of other more reliable*

sources of information"—The disparity between analysts' published theoretical valuations of Marathon's assets and its stock price (DX 858) confirms that the publicly-available sources of speculative information were recognized to be unreliable bases for valuing Marathon's stock. However, Marathon's public reports contained a wealth of information, including its historical earnings and even hypothetical estimated values of its assets, including proved reserves, which—unlike the Strong and First Boston Reports—had been prepared in accordance with SEC-mandated methodology. (DX 211-13; Tr. 713, 723-24, 772-74, 1083-85, 1088, 2047-75, 2157, 2163).

Thus, analysis of the factors underlying the *Flynn* test leads inductably to the conclusion that the Strong and First Boston Reports were precisely the type of "soft" information which should not have been disclosed to investors. Because of the unquestionable potential of those Reports to mislead shareholders, the Marathon respondents did not disclose them when urging shareholders to reject the Mobil offer. That same potential to mislead existed when Marathon and U.S. Steel announced their agreement, and respondents wisely and properly chose not to disclose the Reports at that time.

C. The Court Below Properly Understood SEC Rules and Policies, and Its Decision Is Entirely Consistent With Those Rules and Policies.

Petitioners' efforts to find in the Sixth Circuit's opinions in this case and *Starkman* some misinterpretation of SEC rules or policy ignores the fact that SEC rules and policy played no part in the jury verdict. While the district court heard extensive argument on SEC rules and policy, it declined to grant respondents' summary judgment or directed verdict motions on that basis, and it declined respondents' request to reference in the jury instructions the SEC rules on disclosure of oil and gas reserves. (Tr. 2291, 2384-97, 2399-402). Petitioners did not request any jury instruction on this point. Thus, even if the Sixth Circuit's sub-

sequent conclusion that the SEC rules prohibited (rather than permitted) disclosure of the First Boston and Strong Reports were erroneous, it would have no impact on the judgment which petitioners seek to reverse.

There is no conflict between the Sixth and Third Circuits with respect to SEC rules and policies covering disclosure of estimated oil and gas reserve quantities and values. The *Flynn* case did not address appraisals of oil and gas reserves and did not even mention the specific SEC rules applicable to disclosure of that information. Thus, there is no basis for the third ground for certiorari advanced in the petition.

The Sixth Circuit's reading of SEC rules and practice concerning disclosure of oil and gas reserves is plainly correct. The starting point for any discussion of SEC rules and policy concerning such information is the clear language of Regulation S-K in effect at the time of U.S. Steel's tender offer for Marathon.

> "Estimates of probable or possible reserves and any estimated value thereof shall not be disclosed in any document publicly filed with the Commission."[23]

In Securities Act Release No. 6008, the SEC adopted the prohibition and clearly articulated its underlying purpose [*Id.* at 81,104.]:

> "[S]ince in the past an occasional document has contained information concerning probable or possible reserves when originally filed, the Commission believes that an affirmative statement reflecting the present practice is appropriate. The reason the Commission does not permit disclosure of those reserves is that estimates of probable or possible reserves and any value

23. Regulation S-K, 17 C.F.R. Part 229.102, Instruction 5 to Item 102, 6 Fed. Sec. L. Rep. (CCH) ¶ 71,012. *See* SEC Securities Act Rel. No. 6008 (Dec. 19, 1978), *reprinted in* [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,768. Contrary to petitioners' assertion (Pet. 28), the First Boston Report in fact contains estimates of probable reserves (DX 228), and Regulation S-K thus applied to both the Strong and First Boston Reports.

> thereof are not sufficiently reliable to be included in any publicly filed document and disclosure of this information may be misleading to investors."

Regulation S-K's flat prohibition against disclosure of probable and possible reserves is not the result of an inadvertent failure to conform this provision to an "evolution toward more and more disclosure of so-called 'soft' information." (Pet. 24). Regulation S-K was adopted in December 1978—after the SEC had deleted future earnings from its list of examples of misleading disclosures in proxy statements and after it had proposed a safe harbor provision for "forward-looking statements, such as future earnings, made in good faith . . ." (Pet. 25).[24] The timing of the adoption of Regulation S-K thus makes clear that the SEC deliberately subjected estimates of quantity and value of oil and gas reserves to distinct and concrete rules.

The 1981 release proposing a change to Regulation S-K[25] (No. 6332) (Pet. 25-26) is not to the contrary. That proposed rule change had not been adopted at the time of U.S. Steel's tender offer and, indeed, has *never* been adopted. In Securities Act Rel. No. 6383 (March 3, 1982),[26] the SEC explained:

> "Instruction 5 to Item 102 was proposed to be revised to permit disclosure of less than proved or probable reserves in certain cases where the staff of the Commission could be shown that such disclosure was required by foreign law or was necessary to prevent the disclosure from being misleading. The conditions

24. *See* SEC Securities Act Rel. No. 5699 (April 23, 1976), *reprinted in* [1975-76 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,461; SEC Securities Act Rel. No. 5993 (Nov. 7, 1978), *reprinted in* [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,757.

25. SEC Securities Act Rel. No. 6332 (Aug. 12, 1981), *reprinted in* [1981-82 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,016.

26. SEC Securities Act Rel. No. 6383 (March 3, 1982), *reprinted in* [1937-82 Accounting Series Rel. Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 72,328 at 63,003.

> proposed as the basis for inclusion of such information were the subject of commentator criticism. As a result, Instruction 5 has been revised to permit disclosure of less than proved oil and gas reserves, or proved or probable reserves in other cases, where such information is required by foreign or state law to be disclosed in the document. The Instruction now also permits such reserve data to be disclosed where it has been provided previously to a person (or any of its affiliates) that is engaged in an acquisition of the registrant or its equity securities."

The final revisions adopted in 1982, consequently, reject the proposal that other than proved reserves be disclosed if it is shown to the SEC staff that failure to disclose such reserves would render the document materially misleading. Whatever the source of the dictum on SEC staff practice in Release No. 6332 (quoted at Pet. 26), it is clear that the proposal represented a substantial change which elicited criticism from commentators and which, upon reflection, the SEC concluded should not be adopted.[27]

The change which the SEC did adopt in 1982 (after the U.S. Steel tender offer)—to permit (but not require)[28]

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27. The letter of Mr. Charles Schwartz, then secretary of U.S. Steel, in support of the proposed rule change (Appendix, p. 23A) does not assist petitioners. Petitioners' effort to convert U.S. Steel's support for a proposed rule change into acquiescence with a nonexistent SEC practice is belied by the letter itself. The focus of Mr. Schwartz's letter was on mineral reserves, other than oil and gas, for which a different set of SEC rules applied. In concluding the paragraph on reserve data, after having supported the rule change generally (while at the same time acknowledging that current rules prohibited such disclosure), Mr. Schwartz clearly indicated that a different standard for disclosure of oil and gas reserves might continue to be appropriate: "Finally, we suggest that the Commission consider that other circumstances still warrant treating oil and gas reserves differently from the other reserves." (Appendix, p. 27A).

28. The fact that the Sixth Circuit properly recognized that disclosure is only permitted under the new 1982 rule (Pet. 27-28) hardly aids petitioners' argument. The fundamental point, recognized by the court of appeals, is that such disclosure was prohibited at the time of U.S. Steel's tender offer in 1981.

disclosure of reserve data when it had previously been provided to a person engaged in an acquisition of the registrant—refutes petitioners' position. The need for an amendment in order to allow such disclosure underscores the fact that the SEC forbade it at the time U.S. Steel made its tender offer in 1981.

SEC Staff Accounting Bulletin No. 47, Topic 12, Section 3(b) ("Staff Accounting Bulletin"),[29] of which petitioners quote only a fragment (Pet. 27), also makes clear that the SEC prohibited disclosure of values of probable and possible oil and gas reserves at the time of U.S. Steel's offer. The entire bulletin, including its assumed facts, which were omitted from the petition, makes clear that the SEC indicated only that values of undeveloped leasehold *acreage*, based on comparable sales of similar acreage and related factors—not petroleum *reserves valued using a DCF methodology*—could be disclosed, which, of course, is not an issue in this case.[30]

The rules that applied to disclosure of proved oil and gas reserves at the time of U.S. Steel's tender offer further undercut petitioners' position. The rules permitted disclosure of estimates of quantities of proved reserves, and required in the notes to financial statements an estimate of the present value of future net cash flow from those reserves calculated in a manner far different from the methods used in the Strong and First Boston Reports. The rule governing those disclosures—contained in Regulation S-X[31]—prescribed a uniform method to be used in reporting those numbers, mandating, for example, that no significant assumptions were to be disclosed or used except as specifically provided in the Regulation. SEC Account-

29. Staff Accounting Bulletin 47 (Sept. 16, 1982), *reprinted in* 6 Fed. Sec. L. Rep. (CCH) ¶ 74,211 at 63,944.

30. *Id.* All of the relevant portion of the Bulletin is reproduced in the Appendix at p. 34A.

31. 17 C.F.R. § 210.4-10(k)(5)-(6). Marathon, of course, had made the disclosures required by Regulation S-X in its Annual Reports. (Pet. 26 n.12).

ing Series Release No. 253 (Aug. 31, 1978), *reprinted in* [1937-82 Accounting Series Rel. Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 72,275.[32]

Finally, SEC Rule 13e-3, 17 C.F.R. § 240.13e-3, does not change the basic SEC prohibition against disclosure of probable or possible oil and gas reserves. That rule (which does not mention oil and gas reserves) requires disclosure of certain "outside" asset appraisals, but only in the context of a "Rule 13e-3 transaction".[33] The Sixth Circuit held that U.S. Steel's tender offer was not a "Rule 13e-3 transaction," and petitioners do not seek review of that decision. 772 F.2d at 253-55.

There is neither a conflict between circuits nor a judicial disregard of applicable SEC rules. Petitioners' third ground for their petition is, therefore, without merit.

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32. The SEC implicitly recognized that even estimates of the quantity and future net cash flow of proved reserves disclosed in the carefully circumscribed fashion required by Regulation S-X may turn out to be misleading by providing a safe harbor provision for those who comply with the Regulation. SEC Accounting Series Release No. 257 (Dec. 19, 1978), *reprinted in* [1937-82 Accounting Series Rel. Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 72,279 at 62,749-47.

33. Rule 13e-3 applies to so-called "going private" transactions by an issuer with itself or an affiliate. As the SEC releases make clear and as the Sixth Circuit noted below (772 F.2d at 253-55), the SEC has concluded that there should be more detailed disclosure in such transactions than would normally be required for a transaction negotiated at arm's-length. SEC Exchange Act Rel. No. 16075 (Aug. 2, 1979), [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,166. *See also* SEC Exchange Act Rel. No. 11231 (Feb. 6, 1975), [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,104. Although the U.S. Steel/Marathon negotiations were conducted at arms-length, the merger, but not the tender offer, was nonetheless technically subject to Rule 13e-3. Accordingly, the First Boston Report was disclosed in the Proxy Statement as an "outside appraisal" under Rule 13e-3, and, under those circumstances, the Strong Report was disclosed as well.

IV.

Conclusion

For the foregoing reasons, the Petition for a Writ of Certiorari to the Court of Appeals for the Sixth Circuit should be denied.

Respectfully submitted,

HALIBURTON FALES, 2d*
RICHARD J. HOLWELL
THOMAS MCGANNEY
RICHARD W. REINTHALER
DWIGHT A. HEALY

WHITE & CASE
1155 Avenue of the Americas
New York, New York 10036
(212) 819-8200

JOHN W. BEATTY
DINSMORE & SHOHL
2100 Fountain Square Plaza
Cincinnati, Ohio 45202
(513) 621-6747

Attorneys for Respondents, United States Steel Corporation, et al.

ERWIN N. GRISWOLD
JOHN L. STRAUCH*
JOHN M. NEWMAN, JR.
ROBERT R. WELLER
JOHN W. EDWARDS II
JAMES R. JOHNSON

JONES, DAY, REAVIS & POGUE
1700 Huntington Building
Cleveland, Ohio 44115
(216) 348-3939

Attorneys for Respondents, Marathon Oil Company, et al.

* *Counsel of Record.*

Dated: January 15, 1986

APPENDIX

§ 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j

Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

§ 14(e) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n(e)

Untrue statement of material fact or omission of fact with respect to tender offer

(e) It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation. The Commission shall, for the purposes of this subsection, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative.

§ 23(a)(1) of the Securities Exchange Act of 1934, 15 U.S.C. § 78w(a)(1)

Rules, regulations, and orders; annual reports

(a) Power to make rules and regulations; considerations; public disclosure

(1) The Commission, the Board of Governors of the Federal Reserve System, and the other agencies enumerated in section 78c(a)(34) of this title shall each have power to make such rules and regulations as may be necessary or appropriate to implement the provisions of this chapter for which they are responsible or for the execution of the functions vested in them by this chapter, and may for such purposes classify persons, securities, transactions, statements, applications, reports, and other matters within their respective jurisdictions, and prescribe greater, lesser, or different requirements for different classes thereof. No provision of this chapter imposing any liability shall apply to any act done or omitted in good faith in conformity with a rule, regulation, or order of the Commission, the Board of Governors of the Federal Reserve System, other agency enumerated in section 78c(a)(34) of this title, any self-regulatory organization, notwithstanding that such rule, regulation, or order may thereafter be amended or rescinded or determined by judicial or other authority to be invalid for any reason.

SEC Rule 13e-3, 17 C.F.R. § 240.13e-3

Going private transactions by certain issuers or their affiliates.

(a) *Definitions.* Unless indicated otherwise or the context otherwise requires, all terms used in this section and in Schedule 13E-3 [§ 240.13e-100] shall have the same meaning as in the Act or elsewhere in the General Rules and

Regulations thereunder. In addition, the following definitions apply:

(1) An "affiliate" of an issuer is a person that directly or indirectly through one or more intermediaries controls, is controlled by, or is under common control with such issuer. For the purposes of this section only, a person who is not an affiliate of an issuer at the commencement of such person's tender offer for a class of equity securities of such issuer will not be deemed an affiliate of such issuer prior to the stated termination of such tender offer and any extensions thereof:

(2) The term "purchase" means any acquisition for value including, but not limited to, (i) any acquisition pursuant to the dissolution of an issuer subsequent to the sale or other disposition of substantially all the assets of such issuer to its affiliate, (ii) any acquisition pursuant to a merger, (iii) any acquisition of fractional interests in connection with a reverse stock split, and (iv) any acquisition subject to the control of an issuer or an affiliate of such issuer;

(3) A "Rule 13e-3 transaction" is any transaction or series of transactions involving one or more of the transactions described in paragraph (a)(3)(i) of this section which has either a reasonable likelihood or a purpose of producing, either directly or indirectly, any of the effects described in paragraph (a)(3)(ii) of this section;

(i) The transactions referred to in paragraph (a)(3) of this section are:

(A) A purchase of any equity security by the issuer of such security or by an affiliate of such issuer;

(B) A tender offer for or request or invitation for tenders of any equity security made by the issuer of such class of securities or by an affiliate of such issuer; or

(C) A solicitation subject to Regulation 14A [§§ 240.14a-1 to 240.14a-103] of any proxy, consent or authorization

of, or a distribution subject to Regulation 14C [§§ 240.14c-1 to 14c-101] of information statements to, any equity security holder by the issuer of the class of securities or by an affiliate of such issuer, in connection with: a merger, consolidation, reclassification, recapitalization, reogranization or similar corporate transaction of an issuer or between an issuer (or its subsidiaries) and its affiliate; a sale of substantially all the assets of an issuer to its affiliate or group of affiliates; or a reverse stock split of any class of equity securities of the issuer involving the purchase of fractional interests.

(ii) The effects referred to in paragraph (a)(3) of this section are:

(A) Causing any class of equity securities of the issuer which is subject to section 12(g) or section 15(d) of the Act to be held of record by less than 300 persons; or

(B) Causing any class of equity securities of the issuer which is either listed on a national securities exchange or authorized to be quoted in an inter-dealer quotation system of a registered national securities association to be neither listed on any national securities exchange nor authorized to be quoted on an inter-dealer quotation system of any registered national securities association.

(4) An "unaffiliated security holder" is any security holder of an equity security subject to a Rule 13e-3 transaction who is not an affiliate of the issuer of such security.

(b) *Application of section to an issuer (or an affiliate of such issuer) subject to section 12 of the Act.* (1) It shall be a fraudulent, deceptive or manipulative act or practice, in connection with a Rule 13e-3 transaction, for an issuer which has a class of equity securities registered pursuant to section 12 of the Act or which is a closed-end investment company registered under the Investment Company Act of 1940, or an affiliate of such issuer, directly or indirectly

(i) To employ any device, scheme or artifice to defraud any person;

(ii) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or

(iii) To engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person.

(2) As a means reasonably designed to prevent fraudulent, deceptive or manipulative acts or practices in connection with any Rule 13e-3 transaction, it shall be unlawful for an issuer which has a class of equity securities registered pursuant to section 12 of the Act, or an affiliate of such issuer, to engage, directly or indirectly, in a Rule 13e-3 transaction unless:

(i) Such issuer or affiliate complies with the requirements of paragraphs (d), (e) and (f) of this section; and

(ii) The Rule 13e-3 transaction is not in violation of paragraph (b)(1) of this section.

(c) *Application of section to an issuer (or an affiliate of such issuer) subject to section 15(d) of the Act.* (1) It shall be unlawful as a fraudulent, deceptive or manipulative act or practice for an issuer which is required to file periodic reports pursuant to Section 15(d) of the Act, or an affiliate of such issuer, to engage, directly or indirectly, in a Rule 13e-3 transaction unless such issuer or affiliate complies with the requirements of paragraphs (d), (e) and (f) of this section.

(2) An issuer or affiliate which is subject to paragraph (c)(1) of this section and which is soliciting proxies or distributing information statements in connection with a transaction described in paragraph (a)(3)(i)(A) of this section may elect to use the timing procedures for con-

ducting a solicitation subject to Regulation 14A (§§ 240.14a-1 to 240.14a-103) or a distribution subject to Regulation 14C (§§ 240.14c-1 to 240.14c-101) in complying with paragraphs (d), (e) and (f) of this section, provided that if an election is made, such solicitation or distribution is conducted in accordance with the requirements of the respective regulations, including the filing of preliminary copies of soliciting materials or an information statement at the time specified in Regulation 14A or 14C, respectively.

(d) *Material required to be filed.* The issuer or affiliate engaging in a Rule 13e-3 transaction shall, in accordance with the General Instructions to the Rule 13e-3 Transaction Statement on Schedule 13E-3 [§ 240.13e-100]:

(1) File with the Commission eight copies of such schedule, including all exhibits thereto;

(2) Report any material change in the information set forth in such schedule by promptly filing with the Commission eight copies of an amendment on such schedule; and

(3) Report the results of the Rule 13e-3 transaction by filing with the Commission promptly but no later than ten days (ten business days if Rule 13e-4 [§ 240.13e-4] is applicable, after the termination of such transaction eight copies of a final amendment to such schedule.

(e) *Disclosure of certain information.* (1) The issuer or affiliate engaging in the Rule 13e-3 transaction, in addition to any other information required to be disclosed pursuant to any other applicable rule or regulation under the federal securities laws, shall disclose to security holders of the class of equity securities which is the subject of the transaction, in the manner prescribed by paragraph (f) of this section, the information required by Items 1, 2, 3, 4, 5, 6, 10, 11, 12, 13, 14, 15 and 16 of Schedule 13e-3 [§ 240.13e-100], or a fair and adequate summary thereof, and Items 7, 8 and 9 and include in the document which

contains such information the exhibit required by Item 17(e) of such Schedule. If the Rule 13e-3 transaction involves (i) a transaction subject to Regulation 14A [§§ 240.14a-1 to 240.14a-103] or 14C [§§ 240.14c-1 to 240.14c-101] of the Act, (ii) the registration of securities pursuant to the Securities Act of 1933 and the General Rules and Regulations promulgated thereunder, or (iii) a tender offer subject to Regulation 14D [§§ 240.14d-1 to 240.14d-101] or Rule 13e-4 [§ 240.13e-4], such information shall be included in the proxy statement, the information statement, the registration statement or the tender offer for or request or invitation for tenders of securities published, sent or given to security holders, respectively.

(2) If any material change occurs in the information previously disclosed to security holders of the class of equity securities which is the subject of the transaction, the issuer or affiliate shall promptly disclose such change to such security holders in the manner prescribed by paragraph (f)(1)(iii) of this section.

(3) Any document transmitted to such security holders which contains the information required by paragraph (e)(1) of this section shall:

(i) Set forth prominently the information required by Items 7, 8 and 9 of the Rule 13e-3 Transaction Statement on Schedule 13E-3 [§ 240.13e-100] in a Special Factors section to be included in the forepart of such document; and

(ii) Set forth on the outside front cover page, in capital letters printed in bold face roman type at least as large as ten point modern type and at least two points leaded, the statement in paragraph (e)(3)(ii)(A) of this section, if the Rule 13e-3 transaction does not involve a prospectus, or the statement in paragraph (e)(3)(ii)(B) of this section, if the Rule 13e-3 transaction involves a prospectus, and in the latter case such statement shall be used in lieu of that

required by Item 501(c)(5) of Regulation S-K (§ 229.501 of this chapter).

(A) THIS TRANSACTION HAS NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION NOR HAS THE COMMISSION PASSED UPON THE FAIRNESS OR MERITS OF SUCH TRANSACTION NOR UPON THE ACCURACY OF ADEQUACY OF THE INFORMATION CONTAINED IN THIS DOCUMENT. ANY REPRESENTATION TO THE CONTRARY IS UNLAWFUL.

(B) NEITHER THIS TRANSACTION NOR THESE SECURITIES HAVE BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION. THE COMMISSION HAS NOT PASSED UPON THE FAIRNESS OR MERITS OF THIS TRANSACTION NOR UPON THE ACCURACY OR ADEQUACY OF THE INFORMATION CONTAINED IN THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS UNLAWFUL.

Instructions. 1. Negative responses to any item of Schedule 13E-3 [§ 240.13e-100] need not be included in the information disseminated to security holders unless otherwise indicated.

2. Although the financial information necessary to present a fair and adequate summary of Item 14 of Schedule 13E-3 [§ 240.13e-100] may vary depending on the facts and circumstances involved, the following historical and pro forma summary financial information normally will be sufficient for purposes of paragraph (e) of this section:

(a) The following summary financial information for (i) the two most recent fiscal years and (ii) the latest year-to-date interim period and corresponding interim period of the preceding year:

Income Statement:

Net sales and operating revenues and other revenues
Income before extraordinary items
Net Income
Balance Sheet (at end of period):

Working capital
Total assets
Total assets less deferred research and development charges and excess of cost of assets acquired over book value.
Shareholder's equity
Per Share:[1]
Income per common share before extraordinary items
Extraordinary items
Net income per common share (and common share equivalents, if applicable)
Net income per share on a fully diluted basis

(b) Ratio of earnings to fixed charges for the same periods required by 2(a) above:

(c) Book value per share as the most recent fiscal year end and as of the date of the latest interim balance sheet; and

(d) If material, pro forma data for the summarized financial information described in 2(a), (b), and (c) above, disclosing the effect of the transaction, should be provided for the most recent fiscal year and latest year-to-date interim period.

If the information required by Item 14 is summarized, appropriate instructions should be included stating how more complete financial information can be obtained.

(f) *Dissemination of disclosure.* (1) If the Rule 13e-3 transaction involves a purchase as described in paragraph (a)(3)(i)(A) of this section or a vote, consent, authorization, or distribution of information statements as described in paragraph (a)(3)(i)(C) of this section, the insurer or affiliate engaging in the Rule 13e-3 transaction shall:

(i) Provide the information required by paragraph (e) of this section: (A) In accordance with the provisions of

1. Average number of shares of common stock outstanding during each period was———(as adjusted to give effect to stock dividends or stock splits).

any applicable Federal or State law, but in no event later than 20 days prior to: any such purchase; any such vote, consent or authorization; or with respect to the distribution of information statements, the meeting date, or if corporate action is to be taken by means of the written authorization or consent of security holders, the earliest date on which corporate action may be taken: *Provided, however,* That if the purchase subject to this section is pursuant to a tender offer excepted from Rule 13e-4 by paragraph (g)(5) of Rule 13e-4, the information required by paragraph (e) of this section shall be disseminated in accordance with paragraph (e) of Rule 13e-4 no later than 10 business days prior to any purchase pursuant to such tender offer, (B) to each person who is a record holder of a class of equity securities subject to the Rule 13e-3 transaction as of a date not more than 20 days prior to the date of dissemination of such information.

(ii) If the issuer or affiliate knows that securities of the class of securities subject to the Rule 13e-3 transaction are held of record by a broker, dealer, bank or voting trustee or their nominees, such issuer or affiliate shall (unless Rule 14a-3(d) [§ 240.14a-3(d)] or 14c-7 [§ 240.14c-7] is applicable) furnish the number of copies of the information required by paragraph (e) of this section that are requested by such persons (pursuant to inquiries by or on behalf of the issuer or affiliate), instruct such persons to forward such information to the beneficial owners of such securities in a timely manner and undertake to pay the reasonable expenses incurred by such persons in forwarding such information; and

(iii) Promptly disseminate disclosure of material changes to the information required by paragraph (d) of this section in a manner reasonably calculated to inform security holders.

(2) If the Rule 13e-3 transaction is a tender offer or a request or invitation for tenders of equity securities which

is subject to Regulation 14D [§§ 240.14d-1 to 240.14d-101] or Rule 13e-4 [§ 240.13e-4], the tender offer containing the information required by paragraph (e) of this section, and any material change with respect thereto, shall be published, sent or given in accordance with Regulation 14D or Rule 13e-4, respectively, to security holders of the class of securities being sought by the issuer or affiliate.

(g) *Exceptions.* This section shall not apply to:

(1) Any Rule 13e-3 transaction by or on behalf of a person which occurs within one year of the date of termination of a tender offer in which such person was the bidder and became an affiliate of the issuer as a result of such tender offer: *Provided,* That the consideration offered to unaffiliated security holders in such Rule 13e-3 transaction is at least equal to the highest consideration offered during such tender offer and *Provided further,* That:

(i) If such tender offer was made for any or all securities of a class of the issuer;

(A) Such tender offer fully disclosed such person's intention to engage in a Rule 13e-3 transaction, the form and effect of such transaction and, to the extent known, the proposed terms thereof; and

(B) Such Rule 13e-3 transaction is substantially similar to that described in such tender offer; or

(ii) If such tender offer was made for less than all the securities of a class of the issuer:

(A) Such tender offer fully disclosed a plan of merger, a plan of liquidation or a similar binding agreement between such person and the issuer with respect to a Rule 13e-3 transaction; and

(B) Such Rule 13e-3 transaction occurs pursuant to the plan of merger, plan of liquidation or similar binding agreement disclosed in the bidder's tender offer.

(2) Any Rule 13e-3 transaction in which the security holders are offered or receive only an equity security *Provided*, That:

(i) Such equity security has substantially the same rights as the equity security which is the subject of the Rule 13e-3 transaction including, but not limited to, voting, dividends, redemption and liquidation rights except that this requirement shall be deemed to be satisfied if unaffiliated security holders are offered common stock;

(ii) Such equity security is registered pursuant to section 12 of the Act or reports are required to be filed by the issuer thereof pursuant to section 15(d) of the Act; and

(iii) If the security which is the subject of the Rule 13e-3 transaction was either listed on a national securities exchange or authorized to be quoted in an interdealer quotation system of a registered national securities association, such equity security is either listed on a national securities exchange or authorized to be quoted in an interdealer quotation system of a registered national securities association.

(3) Transactions by a holding company registered under the Public Utility Holding Company Act of 1935 in compliance with the provisions of that Act;

(4) Redemptions, calls or similar purchases of an equity security by an issuer pursuant to specific provisions set forth in the instrument(s) creating or governing that class of equity securities; or

(5) Any solicitation by an issuer with respect to a plan of reorganization under Chapter X of the Bankruptcy Act, as amended, if made after the entry of an order approving such plan pursuant to section 174 of that Act and after, or concurrently with, the transmittal or information concerning such plan as required by section 175 of the Act.

SEC Rule 14d-9, 17 C.F.R. § 240.14d-9

Solicitation/recommendation statements with respect to certain tender offers.

(a) *Filing and transmittal of recommendation statement.* No solicitation or recommendation to security holders shall be made by any person described in paragraph (d) of this section with respect to a tender offer for such securities unless as soon as practicable on the date such solicitation or recommedation is first published or sent or given to security holders such person complies with the following subparagraphs:

(1) Such person shall file with the Commission eight copies of a Tender Offer Solicitation/Recommendation Statement on Schedule 14D-9 (§ 240.14d-101), including all exhibits thereto; and

(2) If such person is either the subject company or an affiliate of the subject company,

(i) Such person shall hand deliver a copy of the Schedule 14D-9 to the bidder at its principal office or at the address of the person authorized to receive notices and communications (which is set forth on the cover sheet of the bidder's Schedule 14D-1 (§ 240.14d-100) filed with the Commission; and

(ii) Such person shall give telephonic notice (which notice to the extent possible shall be given prior to the opening of the market) of the information required by Items 2 and 4(a) of Schedule 14D-9 and shall mail a copy of the Schedule to each national securities exchange where the class of securities is registered and listed for trading and, if the class is authorized for quotation in the NASDAQ interdealer quotation system, to the National Association of Securities Dealers, Inc. ("NASD").

(3) If such person is neither the subject company nor an affiliate of the subject company,

(i) Such person shall mail a copy of the schedule to the bidder at its principal office or at the address of the person authorized to receive notices and communications (which is set forth on the cover sheet of the bidder's Schedule 14D-1 (§ 240.14d-100) filed with the Commission); and

(ii) Such person shall mail a copy of the Schedule to the subject company at its principal office.

(b) *Amendments.* If any material change occurs in the information set forth in the Schedule 14D-9 (§ 240.14d-101) required by this section, the person who filed such Schedule 14D-9 shall:

(1) File with the Commission eight copies of an amendment on Schedule 14D-9 (§ 240.14d-101) disclosing such change promptly, but not later than the date such material is first published, sent or given to security holders; and

(2) Promptly deliver copies and give notice of the amendment in the same manner as that specified in paragraph (a)(2) or paragraph (a)(3) of this section, whichever is applicable; and

(3) Promptly disclose and disseminate such change in a manner reasonably designed to inform security holders of such change.

(c) *Information required in solicitation or recommendation.* Any solicitation or recommendation to holders of a class of securities referred to in section 14(d)(1) of the Act with respect to a tender offer for such securities shall include the name of the person making such solicitation or recommendation and the information required by Items 1, 2, 3(b), 4, 6, 7 and 8 of Schedule 14D-9 (§ 240.14d-101) or a fair and adequate summary thereof: *Provided, however,* That such solicitation or recommendation may omit any of such information previously furnished to security holders of such class of securities by such person with respect to such tender offer.

(d) *Applicability.* (1) Except as is provided in paragraphs (d)(2) and (e) of this section shall only apply to the following persons:

(i) The subject company, any director, officer, employee, affiliate or subsidiary of the subject company;

(ii) Any record holder or beneficial owner of any security issued by the subject company, by the bidder, or by any affiliate of either the subject company or the bidder; and

(iii) Any person who makes a solicitation or recommendation to security holders on behalf of any of the foregoing or on behalf of the bidder other than by means of a solicitation or recommendation to security holders which has been filed with the Commission pursuant to this section or Rule 14d-3 (§ 240.14d-3).

(2) Notwithstanding paragraph (d)(1) of this section, this section shall not apply to the following persons:

(i) A bidder who has filed a Schedule 14D-1 (§ 240.14d-101) pursuant to Rule 14d-3 (§ 240.14d-3);

(ii) Attorneys, banks, brokers, fiduciaries or investment advisers who are not participating in a tender offer in more than a ministerial capacity and who furnish information and/or advice regarding such tender offer to their customers or clients on the unsolicited request of such customers or clients or solely pursuant to a contract or a relationship providing for advice to the customer or client to whom the information and/or advice is given.

(e) *Stop-look-and-listen communication.* This section shall not apply to the subject company with respect to a communication by the subject company to its security holders which only:

(1) Identifies the tender offer by the bidder;

(2) States that such tender offer is under consideration by the subject company's board of directors and/or management;

(3) States that on or before a specified date (which shall be no later than 10 business days from the date of commencement of such tender offer) the subject company will advise such security holders of (i) whether the subject company recommends acceptance or rejection of such tender offer; expresses no opinion and remains neutral toward such tender offer; or is unable to take a position with respect to such tender offer and (ii) the reason(s) for the position taken by the subject company with respect to the tender offer (including the inability to take a position); and

(4) Requests such security holders to defer making a determination whether to accept or reject such tender offer until they have been advised of the subject company's position with respect thereto pursuant to paragraph (e)(3) of this section.

(f) *Statement of management's position.* A statement by the subject company's of its position with respect to a tender offer which is required to be published or sent or given to security holders pursuant to Rule 14e-2 shall be deemed to constitute a solicitation or recommendation within the meaning of this section and section 14(d)(4) of the Act.

SEC Regulation S-K, Item 102, 17 C.F.R., Part 229.102
Description of Property

State briefly the location and general character of the principal plants, mines and other materially important physical properties of the registrant and its subsidiaries. In addition, identify the industry segment(s) that use the properties described. If any such property is not held in fee or is held subject to any major encumbrance, so state and describe briefly how held.

Instructions to Item 102. 1. What is required is such information as reasonably will inform investors as to the suitability, adequacy, productive capacity and extent of utilization of the facilities by the registrant. Detailed descriptions of the physical characteristics of individual properties or legal descriptions by metes and bounds are not required and shall not be given.

2. In determining whether properties should be described, the registrant should take into account both quantitative and qualitative factors. See Instruction 1 to Item 101 of Regulation S-K (§ 229.101).

3. In the case of an extractive enterprise, material information shall be given as to production, reserves, locations, development and the nature of the registrant's interest. If individual properties are of major significance to an industry segment:

A. More detailed information concerning these matters shall be furnished; and

B. Appropriate maps shall be used to disclose location data of significant properties except in cases for which numerous maps would be required.

4. A. If reserve estimates are referred to in the document, the staff of the Office of Engineering, Division of Corporation Finance of the Commission, shall be consulted. That Office may request that a copy of the full report of the engineer or other expert who estimated the reserves be furnished as supplemental information and not as part of the filing. See Rule 418 of Regulation C (§ 230.418 of this chapter) and Rule 12b-4 of Regulation 12B (§ 240.12b-4 of this chapter) with respect to the submission to, and return by, the Commission of supplemental information.

B. If the estimates of reserves, or any estimated valuation thereof, are represented as being based on

estimates prepared or reviewed by independent consultants, those independent consultants shall be named in the document.

5. Estimates of oil or gas reserves other than proved or, in the case of other extractive reserves, estimates other than proved or probable reserves, and any estimated values of such reserves shall not be disclosed in any document publicly filed with the Commission, unless such information is required to be disclosed in the document by foreign or state law; provided, however, that where such estimates previously have been provided to a person (or any of its affiliates) that is offering to acquire, merge or consolidate with the registrant or otherwise to acquire the registrant's securities, such estimates may be included in documents relating to such acquisition.

6. The definitions in § 210.4-10(a) of Regulation S-X [17 CFR 210] shall apply to this Item with respect to oil and gas operations.

SEC Reg. S-X, 17 C.F.R. § 210.4-10(k)(5)-(6)

(5) *Disclosure of estimated quantities of proved oil and gas reserves.* Net quantities of proved reserves and proved developed reserves of crude oil (including condensate and natural gas liquids) and natural gas shall be reported as of the beginning and the end of each fiscal year for which an income statement is required. "Net" quantities of reserves include those relating to the operating and non-operating interests in properties as defined in paragraph (b)(1) of this section. Quantites of reserves relating to royalty interests owned shall be included in "net" quantities if the necessary information is available; if reserves relating to royalty interests owned are not included because the information is unavailable, that fact and the reporting entity's share of oil and gas produced for those royalty interests shall be reported for each year

for which a complete set of financial statements is presented. "Net" quantities shall not include reserves relating to interests of others in properties owned by the reporting entity.

(i) Changes in the net quantities of proved reserves of oil and of gas during each fiscal year for which an income statement is required shall be reported. Changes resulting from each of the following shall be shown separately, with appropriate explanation of significant changes:

(A) *Revisions of previous estimates.* Revisions represent changes in previous estimates of proved reserves, either upward or downward, resulting from new information (except for an increase in proved acreage) normally obtained from development drilling and production history or resulting from a change in economic factors.

(B) *Improved recovery.* Changes in reserve estimates resulting from application of improved recovery techniques shall be separately shown if significant. If not significant, such changes shall be included in revisions of previous estimates.

(C) *Purchases of minerals-in-place.*

(D) *Extensions, discoveries, and other additions.* Additions to proved reserves that result from extension of the proved acreage of previously discovered (old) reservoirs through additional drilling in periods subsequent to discovery and discovery of new fields with proved reserves or of new reservoirs of proved reserves in old fields.

(E) *Production.*

(F) *Sales of minerals in-place.*

(ii) If the reporting entity's proved reserves of oil and gas are located entirely within its home country, that fact shall be disclosed. If some or all of its reserves are located in foreign countries, the disclosures of net quantities

of reserves of oil and gas and changes in them (as required above) shall be separately reported for the entity's home country (if significant reserves are located there) and each foreign geographic area in which significant reserves are located. Foreign geographic areas are individual countries or groups of countries, as appropriate, for meaningful disclosure in the circumstances.

(iii) Net quantities disclosed shall not include oil or gas subject to purchase under long-term supply, purchase, or similar agreements and contracts, including such agreements with foreign governments or authorities. However, quantities of oil and gas subject to such agreements with foreign goverments or authorities as of the end of each fiscal year for which an income statement is required, and the net quantity of oil or gas received under the agreements during each such year, shall be separately disclosed if the reporting entity participates in the operation of the properties in which the oil or gas is located or otherwise serves as the "producer" of those reserves, as opposed, for example, to being an independent purchaser, broker, dealer, or importer.

(iv) In determining the reserve quantities to be reported:

(A) If consolidated financial statements are issued, 100 percent of the net reserve quantities attributable to the parent company and 100 percent of the net reserve quantities attributable to its consolidated subsidiaries (whether or not wholly owned) shall be included.

(B) If the financial statements include investments that are proportionately consolidated, reserve quantities shall include a proportionate share of the investee's net oil and gas reserves.

(C) If the financial statements include investments that are accounted for by the equity method, the investee's net

proved oil and gas reserves shall not be included in the disclosures of reserves. However, the reporting entity's share of the investee's net proved oil and gas reserves shall be separately reported as of the end of each fiscal year for which an income statement is required.

(v) If important economic factors or significant uncertainties affect particular components of proved reserves, explanations shall be provided. Examples include unusually high expected development or lifting costs; the necessity to build a major pipeline or other major facilities before production of the reserves can begin; or contractual obligations to produce and sell a significant portion of reserves at prices that are substantially below those at which the oil and gas could otherwise be sold in the absence of the contractual obligation.

(vi) In reporting reserve quantities and changes in them, oil reserves (which include condensate and natural gas liquids) shall be stated in barrels, and gas reserves in cubic feet.

(vii) If any foreign government restricts the disclosure of estimated reserves for properties under its governmental authority, or amounts under long-term supply, purchase, or similar agreements, or if the foreign government requires the disclosure of reserves other than proved, the registrant should identify the country, cite the law or regulation which restricts or requires such disclosure, and indicate that the reported reserve estimates or amounts do not include figures for the named country or that reserve estimates include reserves other than proved.

(6) *Disclosure of future net revenues from estimated production of proved oil and gas reserves.* In conjunction with the disclosure of changes in net quantities of estimated proved reserves of crude oil (including condensate and natural gas liquids) and natural gas as required by paragraph (k)(5) of this section, the following information

shall be disclosed in financial statements for each geographic classification for which quantities of oil and gas are disclosed:

(i) For each of the following categories: (A) Proved oil and gas reserves, (B) proved developed oil and gas reserves, (C) proved oil and gas applicable to long-term supply or similar agreements with foreign governments in which the entity acts as producer, and (D) the entity's share of proved oil and gas reserves of investees accounted for by the equity method, an amount (the "Estimated Future Net Revenues"), in the aggregate, computed by applying current prices of oil and gas (with consideration of price changes only to the extent provided by contractual arrangements) to estimated future production of proved oil and gas reserves as of the date of the latest balance sheet presented, less estimated future expenditures (based on current costs) to be incurred in developing and producing the proved reserves, and assuming continuation of existing economic conditions. Present separately the amounts applicable to each of the first three succeeding fiscal years, and the remainder in a single amount. Indicate the basis used to compute current prices and current costs.

(ii) The present value of the Estimated Future Net Revenues (the "Present Value of Estimated Future Net Revenues"), as of the end of each fiscal year for which an income statement is required, computed using a discount factor of ten percent, for each of the categories for which Estimated Future Net Revenues are disclosed pursuant to paragraph (k)(6)(i) of this section.

(iii) Any additional information of which management is aware and which it believes is necessary to prevent the above information from being misleading.

United States Steel Corporation Letter to SEC

October 30, 1981

Mr. George A. Fitzsimmons
Secretary
Securities and Exchange Commission
500 North Capitol Street
Washington, D. C. 20549

Re: Files S7-893
S7-894
S7-896

Dear Mr. Secretary:

United States Steel Corporation respectfully submits the following comments regarding the Commission's Integrated Disclosure Program as proposed in the Commission's releases dated August 6, 1981. We support the concept of integration of disclosure requirements under the several federal securities statutes, and in general we favor the proposals contained in the releases. Set forth below are our specific comments on each of the releases, which follow the chronological order of the Securities Act Release Numbers assigned by the Commission to each proposal.

Release Number 33-6331

In general we support the concept of allowing most registrants to fulfill their disclosure obligations under the Securities Act by incorporating their disclosures under the Exchange Act. Since the periodic reports under the Exchange Act are the single most important source of market information concerning publicly traded corporations upon which the market trades previously issued securities of a corporation, this information should form the basis for disclosure concerning newly issued securities.

We have the following comments concerning proposed Form S-3, which would be the primary registration statement form used by widely followed corporations, such as U. S. Steel. We suggest that the requirement that there be $150 million in aggregate market value of common stock held by non-affiliates in the context of continuous offerings be keyed to a specific date, such as the end of the last fiscal year. In the context of a continuous offering, such as a dividend reinvestment plan, the issuer should be allowed to combine its inquiry of its officers and directors concerning their holdings of its securities made for proxy statement purposes with that which it must make for determining holdings for qualification to use of the form as well. There are also three specific items of the form which concern us. Item 2, which requires disclosure of what documents are incorporated by reference and how the reader may obtain them, seems misplaced on the inside cover. We suggest that it be included in the body of the prospectus, perhaps after Item 9. Item 2 is essentially Item 6(b) of present Form S-16, and we feel that it appropriately belongs in the body of the prospectus as it is placed in the current S-16. We also question the appropriateness of Item 9, description of securities to be registered, in registration statements covering the issuance of additional shares of common stock. The description is of necessity a technical summary of the law relating to rights attendant to ownership and is of little interest to the average investor. Item 6(a) of S-16 allows this to be incorporated by reference to the latest registration statement under Section 12 of the Exchange Act, and we feel that this is a more appropriate way of handling the disclosure. Finally, we feel that Item 14 concerning indemnification is meaningless to investors and should not be included anywhere in the registration statement. If the Commission feels that it needs disclosure of indemnification provisions for its enforcement activity (a contention with which we strongly disagree), such disclosure should not be part of the "simplified" dis-

closure system. We also see no need for a summary of the statutory provisions of state corporation law since these provisions are readily available to the Commission, and the Commission and its staff are familiar with them.

Concerning proposed Form S-2, we suggest that the form clearly indicate whether sections of the annual report to security holders other than those specifically referred to in Item 12(a)(3) are deemed to be incorporated into the prospectus for purposes of Sections 11 and 12 of the Securities Act. Whether the remaining sections of the annual report are so incorporated may influence an issuer's decision which option to follow.

We urge the Commission to consider whether there remains any necessity to retain Form S-8, which has become virtually identical to Form S-16. Employees, other than executive officers who by virtue of their positions may have access to all the information they need to make investment decisions, should be afforded the same disclosure and protections as any other investors. If an issuer is not widely followed, employees need the same information contained in Forms S-1 or S-2 as any other investor. The elimination of Form S-8 would also be beneficial to issuers which have multiple registration statements in effect at one time. U. S. Steel, for example, has two employee stock plans and a dividend reinvestment plan currently in effect. If all three registration statements were prepared on the same form it would allow for certain common sections of the registration statements to be prepared for inclusion in all three and would eliminate the problems associated with insuring that the various registration statements comply with the technical differences which will exist between Forms S-3 and S-8.

Finally, we urge the Commission to expand the transaction requirements of Forms S-2 and S-3 to allow these forms to be used in an exchange offer as well as primary and secondary offerings. In our view an exchange offer by a widely followed issuer is essentially equivalent to a primary offering by such an issuer. In either case the

market possesses sufficient information to evaluate the fair market value of the issuer's security. The efficient market theory upon which the entire program is predicated would appear applicable to exchange offers as well as cash offers. While we recognize and sympathize with the Commission's concerns that an exchange offer, especially one in connection with a tender offer, creates a sense of urgency that mitigates against investors' consideration of material incorporated by reference into a prospectus, we feel that the inclusion of the required information of a Form S-1 prospectus in conjunction with a tender offer produces a document which by its very length discourages reading it. Some combination prospectuses and offers to purchase resemble telephone directories, and we feel that they should be significantly shortened to encourage those they are directed at to read them.

Release Number 33-6332

The integration of the Guides to the Preparation and Filing of Registration Statements into Regulation S-K make a great deal of sense. In our view Regulation S-K, as currently in force, provides adequate disclosure, with the exception of two items discussed below, and we agree with the Commission's decision to leave most of its requirements intact.

We question the necessity of setting forth in Regulation S-K a description of the Commission's policy on projections in the general instructions section. Projections are so closely tied to the safe harbor rules, which are proposed to be amended in Release Number 6338, that it seems logical to treat the entire subject in only one rule, with cross references to it where appropriate. We did find the explanation of the policy to be helpful and would suggest inclusion of the material with the Rules.

We suggest that the Commission consider modifying the wording of the instructions to paragraph (a) of Item

102, Description of Property, to clearly indicate that the disclosure should focus on the materiality of the aggregate mineral reserves to the registrant's business and that disclosure concerning individual properties is appropriate only when such properties by themselves represent a material part of the total assets. We also urge the Commission to mandate use of the terminology adopted by the U.S. Geological Survey in Circular 831. As we have commented previously (see letter of December 30, 1980, File No. 57-853), use by the Commission of the terms "proven", "probable" and "possible" instead of the technically defined terms of "measured", "indicated" and "inferred" adds unnecessary confusion to the disclosure of mineral reserves. As is pointed out in Circular 831, the terms "measured" and "proven" are essentially synonymous but "probable" and "indicated" are not. We also question whether there is any need for a specific limitation on the quality of reserves disclosed. Indeed, we feel that the absolute prohibition of inclusion of inferred reserves may itself be misleading. As the Commission is well aware, the non-disclosure of what were then only inferred reserves was the basis of the *Texas Gulf Sulphur* case. We understand and share the Commission's concern that the disclosure of inferred reserves may be misleading if the reader does not understand the nature of such reserves. In U. S. Steel's latest 10-K, we responded to this concern by including a definition of the terms that were used in describing mineral holdings. We feel that the Commission can best protect the public by insisting upon the use of the correct description of all material reserves. Finally, we suggest that the Commission consider whether circumstances still warrant treating oil and gas reserves differently from other reserves.

We have already commented on the Commission's proposed amendments to its rules concerning the disclosure of environmental proceedings (see letter dated August 28, 1981, File S7-884) and, therefore, we will not repeat those

comments in response to proposed Item 103. We would, however, emphasize that in our view the mandated disclosure of masses of trivial information regarding inconsequential environmental proceedings obscures important disclosure and reduces many of the benefits otherwise to be gained through the simplification inherent in the integrated disclosure purpose.

We suggest that the Item 201(c), Dividends, or the related instructions clearly indicate that restrictions on ability to pay dividends does not include the general requirement of statutory corporation law that dividends be paid out of surplus or profits.

Instruction 5 to Item 301, which presents detailed rules concerning the computation of the ratios of earnings to fixed charges, is a new addition to the Selected Financial Data item. The instruction should indicate that presentation of these ratios remains optional with the registrant.

Since we presented our views concerning Items 402 and 403, Management Remuneration, in response to the Commission's recent proposals (see letter of May 15, 1981, File S7-879), we will not repeat them here.

While we agree with the substantive provisions of Item 502, we question the necessity and the practicality that this information be presented on the inside front cover, or in some cases the outside back cover of the prospectus. As stated earlier in this letter concerning Item 2 of Form S-3, this information more properly belongs in the body of the prospectus. We also question, in those cases where several of the subitems would all be applicable, whether all of the required material could be accommodated on the inside front cover, consistent with the Commission's Rules concerning type size, *see* Rules 420 and 12b-12(c).

Concerning Item 510, we would reiterate our position concerning indemnification set forth in response to Release Number 33-6331 above.

Finally, we offer two comments concerning the additions to the Exhibit Requirements, Item 601. First, sub-

item (25) would make the power of attorney forms an exhibit to the registration statement. While we agree that signed copies should be submitted to the Commission, we see no need for these to be exhibits to the registration statement. Subitem (26) requiring as an exhibit a statement that the trustee is eligible and qualified under the Trust Indenture Act of 1939 seems misplaced as an exhibit. We feel that this information should be contained in the trustee's registration under the Trust Indenture Act.

Release Number 33-6333

With two exceptions, the proposed revisions to Regulation C are of a technical nature, and we support the substance of the rules. We do, however, have certain technical and editorial suggestions concerning some of the rules. We have strong reservations concerning Rules 411 and 418 dealing with the impact of incorporation by reference of previously filed documents on the liability provisions of the Securities Act. We feel it more appropriate to make our comments on these rules in connection with Release Number 6337 which more directly deals with this issue.

Rule 405(i) defining dividend reinvestment plans perhaps should be modified to include in the definition plans where a corporation pays brokerage, administration and custody costs. Under the current Internal Revenue Service interpretation of the tax law applicable to such plans, payment of such costs by the company must be prorated to each participant as additional dividend income for tax purposes. Under such plans the participants are deemed to have purchased shares at slightly above the market price since their contribution and cost basis is the pro rata share of all of the purchase prices and the pro rata share of expenses. A literal reading of the proposed definition would exclude such plans from the definition. We would suggest adding the phrase "including plans where the registrant pays fees and expenses for participants" at the end of the definition.

The Commission has requested comments on whether the secretary and treasurer should be listed in the definition of executive officers in Rule 401(m) or be deleted in favor of their coverage where appropriate under the general inclusion of those who perform a policy-making function. We favor the function approach because such titles may not always be representative of a true policy-making role.

Release Number 33-6335

This release, dealing with the interaction of the liability provisions of the Securities Act and the integrated disclosure system, raises the most important issues to be considered in the development of the integrated disclosure system. Unlike liability under Section 10 of the Exchange Act and Sections 17(a)(2) and (3) of the Securities Act, scienter need not be proven to establish liability under Section 11 of the Securities Act. This difference, coupled with the potential liability exposure of the underwriters, has lead some to place more emphasis on the preparation of registration statements than periodic reports. We agree with and support the concept set forth in the release that the key is whether the prospectus and documents incorporated into it taken as an integrated whole contain all of the required disclosures. To us it seems clear that, if the information in a previously filed document is updated by a subsequently filed document and both are then incorporated by reference into a prospectus, the updating can correct the original information which may have become incorrect or misleading. All of the judicial and administrative decisions reviewing the adequacy of disclosures, whether based upon misrepresentations or omissions, under the federal securities laws have held that the entire document must be examined, not merely isolated sections thereof, when evaluating the adequacy of disclosure.

We do not agree with the provision of proposed Rule 412 that, for purposes of Section 11(a), an incorporated by reference document became effective when it was initial-

ly filed. While this would appear to be the only feasible approach for documents (such as 10-Q reports) which are prepared and filed after the registration statement became effective, a different rule should apply for documents that were initially filed prior to the registration statement becoming effective. The point we are making can best be illustrated by the following example. Assume that a company reports in its 10-K that as of December 31 it owned property containing 10,000,000 tons of silver reserves. This statement was inaccurate because only 8 million tons were economically recoverable and thus, 2 million tons should not have been classified as reserves. On July 1 a registration statement became effective and, due to an increase in the market price of silver, as of that date all 10 million tons are economically recoverable. Since the statement is accurate as of the date the registration statement became effective, there should be no liability exposure under Section 11 of the Securities Act. As drafted, the proposed rule suggests that there might be. On a more basic policy level, the rule suggests that in the preparation of registration statements and prospectuses, concentration should be placed on analyzing whether statements in previously filed documents incorporated by reference were accurate when made rather than whether they are complete and accurate at the present time. Therefore, we suggest that the Commission modify the rule so that the effective date of previously filed documents incorporated by reference should be the date of the registration statement's effectiveness. We also suggest that this rule should apply to any liability under Sections 11 and 12 of the Securities Act rather than merely Section 11(a).

Proposed Rule 418 as drafted would require drawing technical distinctions between modification and replacement of statements. While we support the concept of the rule, we would suggest that the rule be redrafted to emphasize that all subsequent periodic reports and documents

modify prior reports and documents and that all documents incorporated by reference when read as a whole are the basis upon which disclosure is judged.

Release Number 33-6336

We support allowing the inclusion of securities ratings in prospectuses and registration statements. As a practical matter, the rating may be the single most important item to many investors in deciding whether to invest. Indeed, many state statutes regulate investments by banks, insurance companies and fiduciaries in debt instruments based upon the ratings. Inclusion of them in the prospectus will be a convenience to investors.

Release Number 33-6337

We have no objection or comments on the technical amendments proposed in the various other rules and forms under the Securities Act which are required to conform these rules to the new nomenclature and terminology contained in the proposals set forth in the other releases. We would suggest, however, that the Commission specifically provide for a method to renew currently effective continuous registration statements on Forms S-7 or S-16 on one of the new forms. U. S. Steel, for example, currently has on file an effective registration statement on Form S-16 for its Dividend Reinvestment Plan. Under this registration, the registered shares will not be exhausted during 1981, and we plan to file a post-effective amendment extending this registration for another year in early 1982. We feel that Rule 401(b) of Regulation C is unclear concerning the filing of post-effective amendments when the form has been rescinded. In the case of the S-16, we would suggest allowing for it to be subject to the new S-3 requirements.

Release Number 33-6338

We generally support the proposed modifications of the Exchange Act regulations and forms to conform to the new

integrated proposal system. We have reservations about deleting the requirement that certain reports on Form 8-K be filed within ten days of the end of the month and replacing it with a "promptly" requirement. We feel that the ten-day requirement serves a necessary function as an outside boundary during which such reports must be filed. The promptness requirement creates an unnecessary ambiguity.

We appreciate this opportunity to present our views to the Commission, and if you desire any additional information, please contact me.

Very truly your,

C. G. Schwartz
Secretary & Assistant
General Counsel

Excerpt From SEC Staff Accounting Bulletin 47 (Sept. 16, 1982), *reprinted in* 6 Fed. Sec. L. Rep. (CCH) ¶ 74,211 at 63,944:

b. *Unproved Properties*

Facts: Disclosures of reserve information are based on estimated quantities of proved reserves of oil and gas. *Regulation S-K prohibits disclosure of estimated quantities of probable or possible reserves of oil and gas and any estimated value thereof in any document publicly filed with the Commission.*

Question: What type of disclosures will be permitted by registrants who wish to indicate that some of their properties have value other than that attributable to proved reserves?

Interpretive Response: The Office of Engineering has, for the past several years, suggested to registrants the following form of disclosure for undeveloped lease *acreage*:

> "In addition to proved reserves, the estimated (or appraised) value of leases or parts of leases to which proved reserves cannot be attributable is $xxx."

The registrant should describe the basis on which the estimate was made. *For example, such estimated values are often based on the market demand for leasehold acreage which, in turn, is based on a number of qualitative factors such as proximity to production.* If the disclosed amount is based on an appraisal, the person making the appraisal should be named.

Excerpts from the District Court's Jury Instructions

[Tr. 2644] There are certain laws and regulations that are involved in this case. Let me read portions of them to you.

Section 10(b) of the Securities Exchange Act of 1934 provides in part as follows:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, to use or employ, in connection with a purchase, any manipulative or deceptive device or contrivance, in contravention of such rules and regulations as the Commission may prescribe.

In connection with Section 10(b) [Tr. 2645] the Commission enacted Rule 10(b)-5, and that provides:

It shall be unlawful for any person, directly or indirectly, by the use or means or instrumentality of interstate commerce, to employ any device, scheme, or artifice to defraud, to make any untrue statement of a material fact, or to omit to state a material fact necessary in order to make the statement made in the light of the circumstances under which they were made not misleading, or to engage in an act, practice, or course of business which operates or would operate as a fraud or deceit upon any person in connection with the purchase or sale of any security.

One more section. Section 14(e) of the Securities Exchange Act of 1934 provides in part:

It shall be unlawful for any person to omit to state any material fact necessary in order to make the statements made in the light of the circumstances under which they are made not misleading in connection with any tender offer or any solicitation of security holders in opposition to or in favor of such offer.

It was the purpose of Congress in passing Section 10(b) and Section 14(b), and it was the purpose of the Securities

Exchange Commission in adopting Rule 10(b)-5, to require a policy of full disclosure.

In light of this standard, before you may [Tr. 2646] find liability upon the defendants, you must find all of the following:

First, that the defendants omitted the alleged fact;

Second, that defendants knew the alleged information at the time, and knowingly and intentionally omitted such facts;

Or, too, that the defendant acted with recklessness;

Third, that the information omitted was material;

Four, that the plaintiffs relied on the documents where the information was omitted;

And five, that those material omissions caused plaintiffs to suffer losses.

Observe: Neither Section 10(b) nor Section 14(e), nor Rule 10(b)-5, imposes any liability for innocent or negligent acts. Liability is imposed only for acts of fraud, recklessness, misrepresentation or omission.

In a situation where an omission to state a material fact is claimed, the plaintiffs are not required to prove reliance. It is incumbent, instead, upon the defendants to establish that there was no reliance.

But defendants have established [Tr. 2647] nonreliance if they prove that even if the Strong Report and the First Boston Report had been disclosed in the tender offer, the results would have been the same.

I used the word recklessness a moment ago as one of the elements. Recklessness is highly unreasonable conduct, which is an extreme departure from standards of ordinary care, and while danger need not be known, it must at least be so obvious that any reasonable man would have known it.

U. S. Steel and Marathon did disclose the Strong and the First Boston Reports in the joint proxy statement which they distributed to the Marathon shareholders dated February 8, 1982, in connection with the proposed merger. That disclosure was made in accordance with Rule 13e-3,

and instructions to Schedule 13(e) of the Securities and Exchange Commission.

I instruct you that the instructions to SEC Schedule 13e were specifically applicable only to the merger transaction, and not to the U. S. Steel tender offer. The inclusion of the reports in the proxy statement relating to the merger does not establish that they should or should not have been disclosed in the tender offer.

Representations concerning future sales, projections, forecasts, and the like, only rise to the level of materiality when they can be calculated with [Tr. 2648] substantial certainty.

Only disclosure of existing material facts is required. Economic forecasts are not.

A failure to make known a projection of future earnings is not a violation of the Federal Securities law.

You must first determine whether the omission of the Strong or First Boston Reports constituted a failure to disclose a material fact.

An omitted fact is material if there is a substantial likelihood that a reasonable person would consider it important in deciding whether to tender his stock.